Banking And Industrial Finance In India

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TO

MY FATHER

PREFACE

I began my study on banking and industrial finance at a time when the subject was in the forefront of all political and economic discussions in this country. The Indian Central Banking Enquiry Committee had just finished their deliberations and businessmen and politicians of almost all shades of opinion were persistently demanding the establishment of special banking institutions on the German or Japanese model in order to finance industry. I felt that undue emphasis was being laid upon the alleged deficiencies of the Indian banking system and that sound and rational economic thinking was being blurred by ulterior political considerations—a curse that has been steadily permeating into almost all discussions of economic problems in this country.

The present work is an attempt to study the problem of banking and industrial finance in India from a strictly economic standpoint and free from all racial or political bias. The preliminary survey was commenced by me in India, but the major portion of the study was done in London at the School of Economics and Political Science. The subject has first been treated from the historical standpoint. Some interesting facts relating to the history and development of the money market in India have been embodied *for the first time*

in this book and considerable new light has been thrown upon other facts which, though not new, have up till now remained comparatively unknown to the student of Indian economics. On the other hand, in the analytical study which occupies the second half of this book, I have tried to consider the systems of industrial finance in other countries and to judge how far the present economic development of India and the fundamental peculiarities of its money market are conducive to the adoption of methods that are foreign to the tradition of this country. Throughout, I have attempted to maintain a broad and comprehensive outlook and to remember that difficulties of industrial finance are but one of the many handicaps from which industry in India suffers.

In conclusion I wish to express my great obligation to Professor Lionel Robbins and Dr. V. Anstey of the London School of Economics under whom I studied this subject and but for whose help and suggestions the present work would never have seen the light of the day. I am also deeply indebted to my friend, Mr. R. W. Parkes, I.C.S., for having helped me a lot during the early stage of collection of statistics and economic data for this book. My thanks are also due to the Librarians of the India Office Library, Guildhall Library, British Museum Library and Library of the Office of the High Commissioner for India in London, and of the Imperial Library, Calcutta, for their ready and courteous help in many matters. Finally, I am profoundly grateful to Sir James Grigg, the present Finance Member of the Government of India, for having kindly gone through practically the whole of my work and made useful criticisms and suggestions

in the light of which I have tried to modify or alter many of my statements. I should, however, make it clear that Sir James is not responsible for any of the views expressed by me in this book.

CALCUTTA,
March, 1936.

N. DAS.

TABLE OF CONTENTS.

Banking and Industrial Finance in India

CHAPTER I

INTRODUCTORY: THE FUNDAMENTAL PROBLEMS OF CAPITAL AND INDUSTRIAL FINANCE

The problem of industrial finance in India raises questions so fundamental and manifold that a proper appreciation of its magnitude and importance is impossible without a preliminary analysis of the functions of capital, and of agencies dealing with the supply of, and demand for, capital. Political bias one way or the other has often blurred sound and rational economic thinking in this matter and the question of industrial finance in India has, in recent years, not infrequently figured as a game-piece in the chess-board of Indian politics.

At the very outset it is important to recognise that currency and bank money are but forms of command over real capital. "They are commonly called capital; but they are really command over capital."[1] A change in the supply of currency and bank money, in the absence of any change in the art of production or in the pressure of population or in the supply of real savings, has little *direct* effect on the rate of interest on permanent investments.[2] This rate is governed mainly by the relation in in which the stock of real capital stands to the demand for its service. Other things being equal, if real capital is scarce, those who need it must pay a heavy price for

[1] Official Papers of Alfred Marshall (London, 1926), p. 270.

[2] Foreward by Prof. L. Robbins to Freidrich A. Hayek's "Prices and Production" (London, 1932).

it; and if it is comparatively abundant, its price will be low.

Whenever there is any depression of industry and trade there is a cry for expansion of currency and credit. When this cry takes the form of a blatant inflationism, the hollowness of the cry can be easily exposed. But there is sometimes an argument of a subtler kind—an inflationism which is supposed to lead the way to an elastic currency expanding and contracting according to changes of demand; it is this pseudo-scientific reasoning that is most dangerous. The general feeling of the individual that he needs more money seems to buttress every argument for a system of currency and credit that will automatically—at least as far as possible—fluctuate with demand.

Now, it is very easy to say that an elastic currency smooths production and thereby promotes the development of industry and trade. The protagonists of an elastic system, however, very seldom care to analyse the chain of events that lie between prices and production. That a change in price-level affects production is admitted by all. What many people seem to overlook is the fact that this influence is exerted by an "individualistic process"—by the play of relative prices on the structure of production.[1] The effect of an increase of money has got to be traced through individual decisions.

The fact is that in order that prices may remain stable, the amount of money in circulation must change as the volume of production increases or diminishes. And in a dynamic society as ours it is not practicable for any agency to keep both price-level steady and main-

[1] For a brilliant analysis, see Hayek, *op. cit.*, Lecture I.

tain the money rate of interest at the equilibrium rate. Any change in the supply of money will have its repercussions on relative price-level and individual production, and thereby disturb equilibrium, even when this change is in response to changes in the volume of production.[1]

The question is how far and in what manner an increase of currency tends to increase capital. "It is not the *quantity* of the circulating medium that produces effects, but the different *distribution* of it". The first effect of the increase of productive activity initiated by the policy of banks to lend below the natural rate of interest is to raise the prices of producers' goods while the prices of consumers' goods rise only moderately. The prices of producers' goods do not, however, rise equally nor do they rise without exception. There is a narrowing of the price-margin between different stages and the final effect is a considerable shifting of goods from some to other stages of production.[2]

Now when the movement of prices is disturbed by movements in the supply of money and credit the application of the original means of production and non-specific intermediate products[3] to longer processes of production is effected *without any preceding reduction in consumption.* When the reduced output from the stages of production from which producers' goods have been withdrawn for use in the higher stages, has matured into consumers' goods, a scarcity of consumers' goods will make itself felt and the prices of these latter will rise. As no

[1] F. A. Hayek: Monetary Theory and the Trade Cycle (London, 1933), Chs. I and IV.

[2] For a detailed analysis, see L. V. Mises: Theorie des Geldes und der Umlaufsmittel (1912), pp. 410-434.

[3] The terms have been borrowed from Hayek's "Prices and Production", (London, 1932).

savings had preceded the change to methods of longer duration, no reserve of consumers' goods would have been accumulated in the form of increased stocks which could now be sold at unreduced prices. But individuals would resist the unforeseen retrenchment of their real income and attempt to overcome it by spending more money on consumption. The result will be a new and reversed change of proportion between the demand for consumers' goods and the demand for producers' goods in favour of the former. The prices of consumers' goods will rise relatively to the prices of producers' goods. This would mean a return to a shorter or less roundabout method of production if the increase in the demand for consumers' goods is not compensated for by a further proportional injection of money by new bank loans granted to producers. But banks cannot continue indefinitely to extend their credit.

No lasting good effects can thus come from credit expansion. If the proportion between the demand for consumers' goods and the demand for producers' goods as determined by the voluntary decisions of individuals is disturbed by the creation of artificial demand, it must mean that part of the available resources is led into a wrong direction and a definite and lasting adjustment is postponed. The only way permanently to "mobilise" all available resources is not to use artificial stimulants, but to leave it to time to effect a permanent cure by the slow process of adapting the structure of production to the means available for capitalistic purposes.

It is important to recognise that in the economic world as we know it rational and justifiable fluctuations of output must be expected to occur. The imperfect divisibility of the process of investment, the crystallisation of

costs in durable instruments in many industries and the intractability of many durable instruments of production combine to make fluctuations a regular feature of the productive process. "Monetary policy can never prevent all fluctuations in the general price-level ; at best it can only express those which are necessary to the establishment of appropriate alternatives in output and repress those which tend to carry the alterations in output beyond the appropriate point".[1]

Let us now analyse the nature of Capital. The essence of the activity of providing capital consists in an individual consuming less during a given period than the value of his current economic output. It is not created by a mere addition of bank loans. The basic problem of capital is that of time valuation. It is a problem of spending and investing, of deciding between various possible enjoyments constituting income, especially between relatively large but deferred enjoyments. There is an eternal conflict between the impulse to spend and the impluse to invest. On the one side is time preference ; on the other, investment opportunity[2].

These two factors should now be analysed. The "impatience" of the individual depends upon the character of his income-stream, its size, its expected distribution in time (that is, whether it is constant, decreasing or increasing, or sometimes one and sometimes the other), its composition (i.e. to what extent it consists of nourishment, of shelter, of amusement, of education and so on), and its probability (i.e. degree of risk or uncertainty). This income-stream is, therefore, very important: it is

[1] D. H. Robertson : Banking Policy and the Price-level (London, 1926), p. 39.

[2] Irving Fisher : The Theory of Interest (New York, 1930), pp. 14-16.

income rather than so-called capital that holds the key to the problem of interest[1].

The other factor is the principle of investment opportunity. We are constantly confronted with the opportunity to choose one income-stream rather than another. We enquire what difference it makes whether one or the other alternative is chosen. And when we choose one, what we actually do is that we choose an opportunity to invest i.e. to incur certain disadvantages or *costs* for the sake of certain advantages or returns[2].

All this shows that it is silly to talk of "capital" being created when the adequate factors are not present. When industry is stagnant it cannot be improved merely by a policy of artificial creation of credit nor can it be set right by inflation. No amount of monetary surgery can solve the fundamental defects of an industrial organisation or structure.

That does not mean, however, that the question of industrial finance is unimportant. The important part played by capital and enterprise in the complex system of production that exists to-day cannot be too strongly emphasised. The "transport of value" which leads to the efficient and harmonious development of industries is facilitated by the agencies that deal with currency and credit. The efficiency of the currency and credit system enables specialisation in production to be carried out on a large scale ; it minimises expenses and risks and facilitates a division of functions that would be otherwise impossible ; it solves the great problem of "transport of

[1] *Ibid*, p. 71.

[2] *Ibid*, p. 175.

capital" between owners of capital and owners of business ability; it lessens the cost of a business undertaking[1].

The first pre-requisite is the provision of a currency which serves as general purchasing power and also as a means of payment; and this currency must have efficiency and a certain amount of stability in value. This service is performed by the currency and credit system of a country.

The service of transporting capital is performed by banks in giving people who need it command over capital. The "investor" wants to convey his capital to those parties from whom he can obtain the highest net return. But this task involves much trouble and skill. It requires an intimate knowledge not only of the businessmen and others who bid for the use of the capital, but also of the undertakings in which they are engaged. The gap is filled by expert intermediaries like banks, issue houses and so on who are in touch, on the one side, with parties in possession of disposable capital, and, on the other, with parties anxious to pay for it. It is the business of the market to facilitate the movement of this stream of command over capital to the points of highest yield.[2]

The work lies partly on the side of supply, partly on the side of demand. On the one hand, the agency of the market lowers the supply price of capital; on the other, it assists in the formulation of a demand. On the side of supply, the market effects economies in the matter of waiting, risk-bearing and marketing—risks arising from imperfect knowledge and from immobility of invested

1 F. Lavington: The English Capital Market (London, 1929), pp. 3-7.

2 *Ibid*, p. 12.

resources. On the side of demand, the market converts the social title of every business opportunity into an effective demand. It gauges prospective earning power, analyses risks and bridges the "economic distance" which it is the function of a market to bridge. The market offers the security and the intermediate organisation needed to investigate the claims of a venture.[1]

It is in the light of the above analysis that the whole problem of industrial finance in India—both in its historical and in its analytical aspects—has to be studied. Historically, we have to consider how far conditions in India could promote the healthy development of savings and investment; we have to analyse the gradual development of the money market and to consider its growing relations to industry and trade; we have to see whether the equipment provided has been adequate to the genuine needs of Indian industry and trade at each successive period. Analytically, we have to consider the whole trend of the flow of investment; we have to study from the standpoint of supply as well as from the standpoint of demand; we have to examine how far the agencies of the market could or could not promote, either by themselves or in conjunction with other factors, the development of industries in India; and, last but not least, we have to estimate the utility and significance of the fundamental forces at work.

[1] *Ibid*, p. 103.

CHAPTER II

THE ORGANISATION OF INDUSTRIES AND THEIR FINANCE BEFORE THE ECONOMIC TRANSITION

The problem of financing industrial operations in India—that connected with the far-reaching questions of long-term credit and the long and tedious process of production—is a matter of comparatively recent growth. We hear very little of such a problem in the early nineteenth or later eighteenth centuries; and the few records and memoirs that have been handed down to us do not throw much light on the problem as such. But it would be a mistake to conclude that the question of industrial finance was unknown in the past; if we hear less of it, this is due to the fact that the fundamental bases of Indian economy in those days prevented the problem from assuming any serious or acute proportions.

The method of finance depends upon the form of industrial organisation, and the essentially different nature of the Indian industrial organisation before the coming of the economic transition necessitated an entirely different mode of finance. It would be a mistake to suppose that in the India of this period there were no organised industries at all. The rambles and recollections of Sleeman, the Annals of Rajasthan by Col. Tod and the extracts from old district records and the pages of the Calcutta Gazette prove beyond doubt the existence of organised industries (especially in the urban areas) in India

before the coming of the economic transition. Broadly speaking, the industries and manufactures were of two classes: those grouped in villages only and those extending to the towns and capitals as well.[1] And the modes of financing these two types of enterprise were, owing to the very nature of their structure, quite distinct.

In any examination of these modes of finance two points should be borne in mind. First, our knowledge is at best scanty, as most of the members of these industries have always been extremely reticent to outsiders about telling the details of their organisation. They have always suspected that the motive of any enquiry into the state of their industrial organisation is to take the bread out of their mouths.[2] Secondly, we cannot definitely assign the older types of industrial organisation to any particular period of history; for years together older forms have been found to co-exist with new types and improved methods of structure. Urban handicrafts have flourished in parts of India side by side with the inauguration and development of modern capitalistic enterprises with their network of factories and plants, and so any description of the industrial structure as it stood before the coming of organised competition of machine-made products from the west cannot be coincident with a definite period like the late eighteenth or the early nineteenth century. The economic transition that brought about the change was a process of slow growth and steady evolution, and this process was by no means uniform over a particular period or in a particular area.

[1] D. R. Gadgil: Industrial Evolution of India in Recent Times (London, 1924), pp. 218-20.

[2] N. G. Mukherjee: A Monograph on Carpet-weaving in Bengal (Calcutta, 1907), p. 2.

Now, the rural industries did not present any serious problem of finance at all. These were concentrated in small villages, isolated from one another, serving mainly local needs and fulfilling their portion of work in the rural economy of India. They presented neither the complexity nor the comprehensiveness of the urban industries of this period. The artisans were mostly village servants, doing all the miscellaneous duties connected with their occupation in the village, and the division of labour was extremely limited.[1] The lack of good roads and the consequent absence of outside competition resulted in an absence of localisation of these types of enterprises, and the artisans were merely members of a village group with purely local means of providing for the simple wants of daily life. Any difficulty in the satisfaction of these wants was met by attracting to the village a body of resident craftsmen and menials, "who were not paid by the job, but were employed by the village on a fixed remuneration, sometimes a bit of rent-free (and perhaps revenue-free) land, sometimes by small payments at harvest, as well as by customary allowances of so many sheaves of corn, millet etc., or certain measures of grain and other requisites in kind."[2]

Usually, each artisan was also given a house-site in the village, or in some cases, as in Madras, in a group outside it forming a sort of suburb.[3] A picturesque description of such artisans and the way in which they were "financed" can be gathered from a monograph

1 Gadgil : *op.cit.*, p. 12.

2 B. H. Baden-Powell: The Indian Village Community (London, 1896), p. 16.

3 Sir W. W. Hunter: Annals of Rural Bengal (London, 1897), p. 102.

of a later period. "The bangle-maker is always a Mussalman and according to the local name for bangles, he is called either *churigar* or *vangrigar*. It appears that he occasionally is not paid for *churis* supplied to a party before marriage, but at the marriage gets about 1 rupee 4 annas and a suit of clothes."[1] The same might be said of the tanner and shoe-maker of the North-West Provinces (now U. P.) : "village *chamars* and *mochis* are divided into two classes, some working for their own living as ordinary artisans, others in the position of servants of the village in which they reside. Those who are village menials differ from other artisans in that they occupy a recognised position in the village community, performing customary services and receiving customary dues, which almost invariably take the form of a fixed share or a fixed amount of the produce."[2] In another of these rural industries, the production of gold and silver-ware, the same organisation is met with. Thus, another monograph records the position of the gold and silver-ware maker in these words: "The ordinary parctice with persons who want ornaments made up is to employ a *sunar* (goldsmith), to give him the metal and to pay him so much per tola for making it up......In this practice the original place of the *sunar* in the social structure appears to be shown. Properly speaking, he is nothing more than a labourer, not a capitalist like the "jeweller" of the western world. In a village the zemindar would call him to his house, give him the raw material and see that he made it up under his own supervision without appropriating any of

1 Monograph on the Pottery and Glass Industries of Bengal (Calcutta), p. 27.

2 Monograph on the Leather Industry of the N. W. Provinces (Lucknow), p. 3.

it and pay him wages like any other labourer".[1] The whole thing is very pithily summed up by a traveller of the period: "Nothing can exceed the simplicity of the oriental manufacturers and mechanics. In Surat and Baroche (Broach ?) the silver-smith, if convenient to his employer, brings his apparatus to the house and there makes such things as are required in a style of strength and neatness that answers every useful purpose."[2] Indeed, in the essentially rural economy of India the problem of financing these artisans and craftsmen did not arise at all : they were members of a homogeneous structure, the small isolated village republics, unknown to the world beyond their confines.

The same cannot, however, be said of the urban industries of the period. Although towns in the modern sense were few, the industries which were concentrated there and in the capitals, and which sometimes extended outside to surrounding villages, formed a vital part of the country's wealth and greatness. The artistic wares, the luxury products and the urban handicrafts catered for a market well beyond the confines of the towns or villages where they were localised : the textile handicrafts of Dacca and Krishnangar, other fine cotton fabrics all over India, the Palampore industries of Madras, the silk manufactures of Murshidabad, the fine flowered brocade work of Benares and Ahmedabad, the woollens of Kashmir and the Punjab, and the brass, copper and bell-metal wares of Benares, Nasik, Poona and Hyderabad—all these were products of highly specialised industrial organisations requiring some capital and

1 A. P. Charles : Gold and Silver-ware produced in the U.P. (Allahabad, 1905), p. 37.

2 James Forbes : Oriental Memoirs, Vol. II (London, 1813), p. 223.

great enterprise and ability.[1] For a considerable number of years most of these were flourishing industries, and some of them, like the *muslins* of Dacca and the woollens of Kashmir, had a vast market in India and beyond.[2]

It is interesting to enquire into the actual organisation of such industries and to analyse whether there was any big problem of industrial finance at all. Here we cannot afford to be dogmatic: there was no one single type or variety of industry and hence the question of their finance has to be considered with all circumspection and care. On the other hand, even a superficial analysis brings out the essentially communal nature of all these industries. Our business is to ask how far the communal spirit extended to the sphere of actual finance.

A most common feature in their organisation was the existence of trade guilds. Our knowledge about the functional importance of these bodies is, however, very scrappy: although guilds were not unknown even in the days of Manu[3] and the guilds of eighteen organised industries in Buddhist India were said to have powers of arbitration even between members of the guilds and their wives,[4] the Muhammadan historians are rather silent on the point. But occasional enquiries

1 Gadgil: *op.cit.*, pp. 35-38.

2 W. H. Sleeman: Rambles and Recollections (London, 1844), p. 125.

3 The Code of Manu says: "A king should enforce his own law only after a careful examination of the laws of castes and districts, guild-laws and family laws."

4 T. W. Rhys Davids: Buddhist India (London, 1903), pp. 96-97. Guilds came into prominence with Buddhist revival: the Buddhists gave unrestricted freedom to the third estate, *viz.*, the Vaisyas. The same is true with regard to the Jains.

carried out by individual experts[1] and the fragmentary records of guilds in the process of decline enable us to make a fairly comprehensive picture of the system.

It should be noted at the outset that the guild organisation was not something peculiar to the urban industries alone. Even the villages had guilds—sometimes one only in a village, and usually the head was the patel, or the chief of the village himself. All the trades of the village were jealous of the entrance of new families into it, but, apart from this and certain other social and religious duties, these village guilds did not have to play a very important part in the simple rural economy of India.[2]

In the big towns and capitals, however, guilds played a much more important part in the strictly economic sphere. Generally, there were two types of guilds—the merchant guild and the guild of artisans; a merchant guild (or a *Mahajan* as it was popularly called) consisted of all the merchants, bankers and large dealers of a city and its leader was called a *Sheth*, while an artisans' guild was a sort of trade-association between workers of identical wares and interests and was usually called a *Panch.*[3] These latter organisations were not exactly coincident with the sectarian or ethical caste of a particular class of artisans, while the former, by very definition, included men of heterogeneous sects and beliefs.[4]

The great merchants' *Mahajan* wielded considerable power over its members: usually it included, as in

[1] Like E. W. Hopkins. *Vide* his "India, Old and New" (New York, 1901).

[2] Hopkins: *op. cit.*, p. 178.

[3] Hopkins: *op. cit.*, p. 178.

[4] Sir G. Birwood: The Industrial Arts of India (Lond., 1880), Vol.I, p. 138.

Broach, bankers, money-changers, brokers, agents, cotton-dealers and others, and was in fact a sort of board of trade or chamber of commerce. The executive authority lay in the headman and elders who were allowed a special position by virtue of their age, experience or family prestige, but who generally held their position by hereditary right.[1] The headman or *Sheth* and his Council formed, as it were, the President and Cabinet of the *Mahajan*: the interest of one was the interest of all and in ordinary circumstances there was a ready acquiescence on the part of the whole guild in any measure brought forward by the *Sheth* and supported by the Council.[2]

Almost without exception each of these merchant guilds had a central fund of its own. Funds were derived in a variety of ways, the mode of impost varying from town to town and from district to district. In Surat, for example, they were derived from fees on cotton and on bills of exchange[3] while in some other places a fee was exacted from new members.[4] In all these the democratic principle—the principle of justice and equality—was adhered to, at least in theory, although the increase of the capital and wealth of individual members often prevented even its nominal application.[5] It is debatable, however, how far the common Treasury,

1 Birwood : *op. cit.*, pp. 138-39,

2 Hopkins : *op. cit.*, p. 186.

3 Bombay Gazetteer (Bombay, 1877), Vol. II, p. 321.

4 Hopkins : *op. cit.*, p. 186. All sons of a deceased member, however, became members of the guild on his decease without paying an entrance fee and were received into the guild without formality. Membership was a family right which, once acquired, was inherited.

5 "Trade Guilds in India" in *The Modern Review* (Calcutta, March, 1911).

into which flowed all imposts, subscriptions and occasional munificent donations, was employed, if at all, in the actual finance of industries. Details are singularly lacking about the employment of any portion of these funds in industrial finance proper, and such being the state of our knowledge we cannot come to the sweeping conclusion that these merchant-guilds were in the nature of great reservoirs of capital for different urban industries.[1] Most of this money was spent on social and religious activities: in the guilds of Western India (where they prevailed chiefly among the Vaishnavas and Jainas of Gujarat) the greater part of the fund was spent on charities and, particularly, charitable hospitals for sick and helpless domestic animals, and also on the temples of the Maharajas of the Wallabacharya sect of Vaishnavas, while much the same state of affairs prevailed in the *Mahajans* in other parts of India as well.[2]

Where then does the importance of these *Mahajans* lie so far as the urban industries are concerned? Their direct share in the actual financing of industries was, at best, small; but they contributed to the maintenance of that homogeneity of interest which was essential to the harmonious development of the different urban industries represented on their councils. They controlled the output of merchants' wares, determined rates of sale and amounts of marketable material and were undoubtedly "indispensable to the advancement of the middle classes in their struggle for recognition at the hands both of despotic kings and of an organised priesthood that was bent on suppressing the elevation of the third caste."[3] It was

1 We should not forget Ashley's warning that it is dangerous to make up for the silence of native chroniclers by foreign analogies.

2 Birdwood: *op. cit.*, p. 140.

3 Hopkins: *op. cit.*, pp. 197-205.

the growth of these guilds that made commerce between the towns as well as with countries abroad possible. Like the English guildmerchant of the mediaeval times, the Indian *Mahajan* regulated the economic life of the town and represented its members in dealings with other towns; and the object of both was the regulation of trade rather than of production.[1] The *Mahajan* punished breaches of commercial morality and tried to maintain fair dealing and a high standard of quality in the goods sold[2]; and while the monopoly of internal trade was undoubtedly the *raison d'être* of this union both in England and in India, the tie was strengthened in India by the observance of religious and social charities which were an almost indispensable adjunct to its various functions.[3] Like the trade-guilds of China, the Indian *Mahajan* established rules and compelled obedience to them, fixed prices and enforced adhesion, settled or modified trade customs and imposed their will on traders in and out of the guild; and sometimes, by the cessation of all business or a threat to do so, it could even cause the local authorities to modify or withdraw its orders.[4] In short, the *Mahajan* solidified the communal character of trade and industrial enterprise, and although it did little towards the actual financing of industry, its services towards the maintenance and development of an organised production and a fairly stable market were by no means insignificant.

1 Vide H. O. Meredith: Outlines of the Economic History of England (London, 1930), p. 56. It is interesting to note the following about the English guild-merchant: "It is probable that common purchases were often made and that loans were made to members out of a common chest." We are not, however, quite so sure of such probabilities about the Indian *Mahajans*.

2 See Hopkins. Cf. W. J. Ashley: An Introduction to English Economic History and Theory (London, 1894), Part I, pp. 71-76.

3 Cf. E. R. A. Seligman: Two Chapters on the Mediaeval Guilds of England (Baltimore, 1897), pp. 25-31.

4 H. B. Morse: The Guilds of China (London, 1909), p. 30. See also the Bombay Gazetteer, Vol. III, p. 251.

We should now consider the economic importance of the smaller guilds or *Panches* as some of them were called—associations of master and craftsmen of a particular industry. These were in very many respects similar to the guilds of "crafts" or "mistries" in mediaeval England. The Indian artisans' guilds were not exactly caste groups : on the one hand, the same caste might have subdivided guilds (e. g. among the silversmiths of Gujrat and Western India) ; on the other, it did sometimes happen that one guild comprised different castes (e. g. among the confectioners of the same district of India).[1] The most important feature of these craft-guilds was the system of apprenticeship : the idea of an inherited trade was kept up by this means and the apprentice found in the guild a school well calculated to fit him for his future career ; he was treated as a junior member and impressed with the feeling of the necessity for self-improvement.[2]

These craft-guilds of the pre-transition period had, like their contemporary *Mahajans*, also central funds of their own. There was some difference, however, in the way in which these funds were made up: in the artisans' guilds there was often no entrance fee at all and no annual subscription either[3] ; on the other hand, fines imposed for non-observance of guild-rules formed an important source of revenue.[4] Sometimes, however, special subscriptions were levied from those who could afford to subscribe

1 Hopkins : *op. cit.*, p. 181.

2 Hopkins : *op. cit.*, p. 183. Hopkins relates, however, that the old law had fallen into disuse and that the impact of Western culture led to a supersession of the old apprenticeship system which was kept up only in name, but violated frequently and with apparent impunity.

3 Hopkins : *op. cit.*, pp. 186-89.

4 This was chiefly applied to the observance of holidays. Vide Hopkins, *op. cit.*, p. 190.

"not less than a rupee,"[1] while at other times a favourite device was for the men of a craft or trade to agree on a certain day to shut all their shops but one, put the monopoly to auction and then credit the guild funds with the highest amount that was bid.[2] On other occasions a *mahajan* (shroff or money-lender) of the guild would advance some money in return perhaps for a more effective control of the fund and, through that, of the members as well. The essentially provisional nature of meeting these emergencies was mainly due to the fact that the aim of these guilds was not the accumulation of money, but rather certain social and charitable observances, and this could be done in the ways mentioned even if no money was previously in hand.[3] As in the *Mahajans*, it is improbable that any considerable amount was spent in the actual financing of the crafts concerned ; dinner parties, annual feasts and occasional charities formed the bulk of the debit side of these funds.[4]

That does not mean that these craft-guilds were economically unimportant. The apprenticeship system, the co-ordinating influence of the unions themselves, and the general insistence on having a high degree of excellence in wares and crafts certainly strengthened and developed the organisation of these arts and crafts. We need not exaggerate the idea of an opposition between the craft-guilds on the one hand and the *Mahajans* on the other : many were members of both organisations and the dividing line between the capitalist owner and the

1 Birdwood : *op. cit.*, p. 140.

2 Bombay Gazetteer, vol II- p. 443.

3 "Trade Guilds in India" in "The Modern Review" (March, 1911), Calcutta.

4 Hopkins : *op. cit.*, p. 190. See also Birdwood : *op. cit.*, pp. 139-41.

working journeyman was by no means inelastic[1]. The pre-transition artisan-guild of India was neither a combination of oppressed plebeians struggling against the patricians nor an outgrowth of the big *Mahajan*: it was more or less a purely voluntary union to which were superadded the customs and traditions of predecessors, and it played a most useful part in the communal economy by regulating wages and other forms of remuneration, by arbitrating in cases of dispute and by administering its own particular funds.[2] Like the craft-guilds of China, the Indian artisans' guilds were mostly of purely democratic origin, without a grant or licence from the governing powers[3]; they promoted the fraternal spirit and accentuated the monopolistic instinct, as in the goldsmiths' guild in Southern India where there was an implicit understanding among the members that they would charge one rupee as fee for every sovereign weight of gold.[4]

It should be noted, however, that the guild was not the only form of organisation in the industries and crafts of the pre-transition period. The guilds were no doubt the more common phenomenon, but sometimes important industries and mining deposits were controlled by the princes themselves. Thus, in Rajputana, the productive mines with the rich tin of Jawara, the copper of Chunbal and the marble quarries of Marwar, were state properties from which an important revenue was derived and which were managed and financed by the

[1] See Hopkins: *op. cit.*, pp. 193-95. Cf. also Seligman: *op. cit.*, pp. 58-60, for an account of the English craft-guilds.

[2] Hopkins: *op. cit.*, pp. 193-96.

[3] R. C. Majumdar: Corporate Life in Ancient India (Calcutta, 1918), pp. 10-30. See also Morse: *op. cit.*, p. 9.

[4] K. R. R. Sastry: South Indian Gilds (Madras, 1925), p. 14.

states themselves.[1] In other cases the features of the guild organisation were maintained only in some specific aspects. While, for example, the wire and tinsel industry of the Punjab presented interesting indications of a strong guild control, the brass and copper manufacturers of the N. W. Provinces were much less organised.[2] In the former all the *kandla-kashes*[3] of Delhi and Lahore worked together in the old mint buildings even as late as the latter part of the nineteenth century—simply to prevent the deterioration of the Lahore manufacture and consequent depression of the trade. "Each *raini* prepared for wire-drawing was taken by the *kandla-kash* to the municipal office where it was tested. The fixed proportion of alloy allowed in a *raini* intended to be drawn into pure *kandla* was 32 rice-grains or 4 *rattis* to the tola. Any *raini* found to contain more than this proportion was destroyed as spurious. The system was an admirable one : the purity of the Lahore *kandla* was guaranteed, the solidarity of the guild was assured by it, and the trade was protected against fraudulent interlopers who might damage the credit of the industry and undersell the pure *kandla-kashes* by placing on the market as genuine any *kandla* wire which contained more than the recognised quota of alloy."[4] About the Delhi guild we have more interesting details. Under the Moghul rule the guild of wire-drawers paid fees to government which in turn supervised the actual

[1] Tod : Annals of Rajast'han, Vol. I, p. 128.

[2] E. Burdon : Monograph on the Wire and Tinsel Industry in the Punjab (Lahore, 1909). Also—G. R. Dampier : Monograph on Brass and Copper ware in the N. W. Provinces (Allahabad, 1894).

[3] *Kandla* is the generic name given to wire made out of gold or an alloy of these metals, the wire being drawn until 10 or 12 yards per tola of metal are produced : the men who are engaged in this process are known as *kandla-kashes*.

[4] Burdon : *op. cit.*, p. 9.

methods of manufacture. When control was assumed by the British the levy of fees was continued, though it does not appear that the impost was ever legally sanctioned: but, so far from objecting, the wire-drawers for years heartily approved of the payment. It was generally considered that supervision by the controlling power, which was a necessary consequence of the levy of fees, gave the industry a special distinction, assured the purity of the *kandla* made, and generally maintained the solidarity of the guild.[1] The influence of the guild organisation was apparent in the manufacture of paper and papier mache´ even in the distant state of of Kasmir: heavy taxation was imposed on all outsiders, guilds of artisans were sanctioned and protected by the state and most stringent measures were taken to guard the secrets of the art.[2]

In contrast to these stood the brass and copper manufactures of the N.W. Provinces, in which, as has been mentioned already, the communal sense was less perfectly developed. Here there were two distinct bodies of men—the *kaseras* or capitalist dealers who were commonly money-lenders and the *thatheras* (or thathiyars) who were the skilled artisans. The connexion between these two classes was of a varying degree of closeness and in extreme cases the latter were practically the slaves of the former, who, by a system of advances which were never paid off, kept them in their power and prevented their disposing of their services to the highest bidder. Although the *thatheras* were not on the whole badly remunerated, the *kaseras*

1 *Ibid*, p. 10.

2 Monograph on Paper-making and Papier Mache´ in the Punjab (Lahore, 1908), p. 1.

controlled the situation, supplying the material and paying a fixed rate per seer for the finished goods, an allowance being made (said to be one-ninth in the case of brass) for waste of material in the manufacture.[1] This absence of a communal guild organisation could be seen elsewhere as well: the *jauharis* (dealers in gold and silver ware) of Agra or Lucknow, for example, were capitalists themselves; they dealt in all kinds of jewellery and plate, put up signs of royal appointment and "would think nothing of showing you an ornament valued at Rs. 15,000."[2] Again, it has been recorded of the shawl manufactures of Kasmir that the goods (after having been finished) were "handed over to the *wafarosh* or person who had advanced money on them to the manufacturer and to the *mohkim* or broker," and these two settled the price and effected the sale to the merchant; the former charged an interest on his advances and the latter got a commission varying from two to five per cent.[3]

Thus we see that although the guild or communal feeling was very strong in certain arts and crafts its *direct* influence on actual finance was practically nil. Undoubtedly both the *Mahajan* and the craft-guild tended to promote the sense of economic solidarity amongst traders of identical or similar wares, and also amongst the workers of a particular craft; and their social and semi-religious festivities, charities and dinners were certainly an expression of this community-sense. Viewed in their perfection, these trade and craft-guilds with their more or

[1] Monograph on Brass and Copper Ware in the N. W. Provinces, *op. cit*, p. 7.

[2] Charles: *op. cit.*, p. 39.

[3] The Report on the Trade and Resources of the Countries on the North-western Boundry of British India (Lahore, 1862), Appendix, p. XXXI.

less democratic organisation perhaps left wide room for the exercise of individual enterprise and initiative without hampering the solidarity of the group or groups as a whole.[1] But we shall be making unwarranted conclusions if we are to assert that the actual financing of the arts and crafts was carried on through the agency of common guild funds : the few data that we have do not encourage us to come to any such conclusion ; on the other hand, there are strong reasons to suppose that the actual problem of finance, if there was a problem at all, was met in ways that would hardly resemble a system of common treasury or common fund.

It is a mistake to talk of vast capital sums needed to finance industries and crafts before the coming of the economic transition. The very nature of the organisation —the method of production and manufacture by small artisans on comparatively small scales, the direct contact between consumer and producer and the system of making to order instead of for stock—precluded the need for a supply of vast sums of capital. As in mediaeval England, capital played a very small part in the manufacture or actual turn-over of goods. "In order to set up as a master artisan, a man only needed to be able to hire a house and buy the necessary tools, plus, as in many crafts, a little money to buy materials."[2] Often even a separate establishment was unnecessary ; arts and crafts could sometimes be pursued in the genial atmosphere of one's own home and, if necessary, with the free help of the members of the family as well. Much more important than capital were skill and connection, the

[1] Cf. R. K. Mukharjee : Democracies of the East (London, 1923) pp. 285-292.

[2] Ashley : *op. cit.*, p. 93. See also Gadgil : *op. cit.*, p. 41.

ability to produce good wares and the steady demand of a small group of customers. The local limitation of demand made the regulation of prices and methods of manufacture very much easier than it would be in modern times, and in many industries the craftsman combined the functions of a trader with those of a manufacturer i.e. he bought his own materials and sold the goods to such customers as presented themselves.[1]

Individualistic ways of finance were necessitated also by the very logic of circumstances: agriculture, India's chief industry, was conducted all over the country on the basis of small peasant proprietorship or cultivating tenants, and hence the distribution of property was much wider in India than in many other countries.[2] The result was that the growth of large stocks of capital (as distinguished from mere hoards) in independent hands was not so easy in India as elsewhere and the independent craftsman was very rarely a big capitalist. So he had either to work to order and on the material supplied by his customers, or to enter into some arrangement with the local money-lender or banker.[3] It was under this system of finance that the sumptuary arts of India were sustained and fostered until at length the vast bullion of the Western nations was poured into the East in exchange for them.

[1] Gadgil: *op. cit.*, pp. 40-42.

[2] Gadgil: *op. cit.*, pp. 219-20.

[3] An interesting experiment could be met with in the Sonthal Parganas where the blacksmiths often grouped themselves into a band of six men conducting a workshop conveniently situated under a grove or a shady tree in the village, while another man supplied the implements and capital. All the six men went on working the whole day, and out of the seven articles manufactured, each of the labourers got one while the seventh one was given to the man who supplied the implements and capital.

E. R. Watson: A Monograph on Iron & Steel work in the Province of Bengal, Calcutta, 1907.

This brings out the importance of the indigenous banker or money-lender in the economic structure of the pre-transition period. Money-lending in India can of course be traced back to about 2000 B. C. in the Vedic period and we have also accounts of the *Sresthis* of ancient India in the *Kautilya* and the *Dharmasastras*, but we do not possess any adequate information about the part played by such indigenous banking in the industrial organisation of those days. Details are available only from about the end of the eighteenth century, but even then they are by no means systematic or comprehensive.[1] It should be noted, however, that indigenous banking during our period ranged from the operations of famous houses like those of Jagat Seth to the petty business of the village money-lender. Further, we should not fall into the error of supposing that *all* these houses had some share, however small, in the actual promotion or finance of industries and crafts. No doubt there was a rich, enterprising commercial and banking class who conducted exchange and industrial operations all over India; but those golden days of immense profits were frequently due to extra-industrial factors: swift runners brought secret news of a decisive battle, or a great military leader would offer any terms for loans which would pay his mutinous troops![2] Often, these banking houses were primarily connected with royal courts: the history of the House of Fateh Chand and the story of the grant of the title of "Jagat Seth" by Emperor Farrukhasiyar as a reward for services rendered to him prove this beyond doubt.[3] Nevertheless, the financing of industries and crafts

1 Sir A. C. Lyall: Asiatic Studies, First Series (London, 1899), p. 258.

2 *Ibid*, p. 259.

3 H. Sinha: Early European Banking in India (London, 1927), p. 2.

during this period was, to a large extent, helped by some of these indigenous bankers. Every village or town had its own money-changer or shroff who acted as banker, made remittances of money and issued *hundis* or bills of exchange.[1] This money-changer or shroff often made great profits out of a number of transactions: thus, records Tavernier again, payment for diamonds had to be made by old *pagodas* (or gold coins) and these had to be tested and certified by the changer who got a liberal commission over the transaction.[2] The existence of widely different coins and currencies made money-changing a lucrative business, and internecine disputes and the political insecurity of the country while increasing the risks of bankers (who might lose the money on the bills of exchange if the goods against which they were drawn were stolen in transit) certainly made speculative profits possible in the case of a number of them.[3] The system of issuing *hundis* or bills of exchange had attained a marvellous degree of perfection and most of the big bankers and shroffs had correspondents "not only in all the great towns of Hindostan itself, whether British, tributary or independent, but even in Cashmere and some parts of Persia." The *hundis* or bills were drawn out in a written character peculiar to the class of bankers and illegible to anyone else; and these were often transmitted by *estaffettees* or special couriers of the issuing houses themselves.[4]

[1] J. B. Tavernier: Travels in India (Tr. by V. Ball), Vol. I (London, 1899), pp. 28-29. Tavernier remarks: "All the Jews who occupy themselves with money exchange in the Empire of the Grand Seigneur pass for being very sharp; but in India they would scarcely be apprentices to these changers."

[2] *Ibid*, pp. 90 92.

[3] L. C. Jain: Indigenous Banking in India (London, 1929), pp. 13-15.

[4] Sketch of the Commercial Resources and Mercantile and Monetary System of British India (London, 1837), p. 45.

Much more relevant to the problem before us is the loan business of these shroffs and bankers ; *hundis* or bills of exchange undoubtedly facilitated the movement of crops as well as of industrial wares, but their direct bearing on the finance of the independent craftsman or artisan was negligible. From the standpoint of loan and investment, it was the money-lending operation pure and simple that was the most important. Before the coming of the economic transition there were roughly five forms of "investment" : land, houses (not very common), ornaments, hoards and, last but not least, money-lending.[1] Money-lending was the business of two main groups—professional and non-professional. The latter included such people as successful shop-keepers, traders and well-to-do cultivators - all in fact whose position enabled them to borrow at low and lend at high rates of interest. From the standpoint of the regular artisan or craftsman, however, the professional shroffs were much the more important ; these varied from the proud bankers or *sahukars* who often confined transactions to granting and cashing bills of exchange only,[2] to the village money-lender or *marwari* who represented the worst type of usury business ; in between ranged such persons as the pawnbroker or *jausan sahukar* lending money only on the security of articles and the usurer or *kisatia* representing the better type of usury business.[3] Now the trader and the small entrepreneur generally borrowed money on personal security from the first type of shroffs, viz., the bankers or *sahukars* proper. The arrangement for

1 Gazetteer of the Bombay Presidency (Bombay, 1877), Vol. II, pp. 183-84.

2 So high was their credit that till recently as the year 1860 depositors were content to receive from them rates of interest as low as 1 or 1½ per cent. *Ibid*, p. 185.

3 *Ibid*, p. 385 *et seq.*

the most part included a stipulation that the amount borrowed would be repaid within a fixed period and the interest charged was moderate, seldom exceeding 9% per annum in Surat and 12% in Broach; bankers were always ready to accommodate any person of this class who had credit and was known to be honest in his dealings.[1] On the other hand, the smaller artisans (like the coppersmiths, braziers and weavers) whose business required a certain amount of capital could, when of good personal credit, generally borrow from the *sahukars* at a slightly higher rate of interest, but still without pledging any special security; and when in times of difficulty the banker would not afford him any extra accommodation, he usually went to the lower grades of money-lender who, of course, charged a fairly high rate of interest and often demanded an additional premium.[2] The security required depended on the character of the transactions and on the position of the borrower: unless the borrower was a stranger, money-lenders did not require any security from the small tradesman, but sometimes artisans and craftsmen had to execute a bond and furnish security in the shape of ornaments or immovable property.[3] Sometimes an intermediate agency like the *pykar* of Bengal stood between the artisans and manufacturers on the one hand and the merchants and shroffs on the other. Thus, in the district of Dacca in Eastern Bengal, *pykars* made purchases of country thread

[1] *Ibid*, p. 191 and p. 450.

[2] The Bombay Gazetteer says of the borrowers in Broach: "In dealings with this class the money-lender takes a bond on stamped paper containing, not infrequently, a stipulation to repay the loan by monthly instalments, at rates of interest varying from 15 to 24% a year. But besides these nominal rates of interest, an artisan or labourer will have to pay a premium, varying, according to his credit, from 1 to 3% of the sum borrowed." (p. 450).

[3] The Bombay Gazetteer, Vol. 8, p. 204.

in the different bazaars in the country and procured cloths for the merchants in the city; an advance of money was made by the merchant and the *pykar* entered into an agreement to deliver to him a certain number of bales of cloth of certain dimensions, quality and number of thread within a specified time; he distributed the money among the weavers and superintended their work and for his trouble received a small commission of about $2\frac{1}{2}$ per cent.[1]

All these show that the finance of indigenous crafts and industries, in so far as it was a problem at all, was easily solved by the existing economy; no doubt there were imperfections—but so long as the crafts and industries had the patronage of the native courts, they had the advantage of a steady local demand that was not subject to the competition of a more highly developed form of industry from the West, so that the imperfections of the system of finance did not make their influences felt.[2] Further, the very fact that capital played such a minor part in the actual organisation and development of industries and crafts was significant: industrial finance with its essentially modern aspects was unknown simply because it was neither necessary nor relevant. The establishment of an alien government with its entirely different system of economy, the chaos and confusion of the days of the consolidation of British power in India and the competition of machine-made goods from the West, however, soon gave a rude shock to the old structure; on the one hand, the decay of industries, caused by factors not directly connected with the actual system of finance, accentuated

1 James Taylor: A Sketch of Topography and Statistics of Dacca (Calcutta, 1840), p. 187.

2 Gadgil: *op. cit.*, pp. 40-43.

the imperfections of the old system of finance ; on the other, the older crafts and industries had to give way to newer enterprises for which different and improved methods of finance had to be discovered.

CHAPTER III

The Decline of the Old Organisation and the Rise of New Agencies of Finance

The establishment of British rule in the Ganges delta and its gradual consolidation and expansion throughout the latter part of the eighteenth century was much more than a challenge to the indigenous economy of India. As the nineteenth century rolled on, the new political factors brought in their train the competition of a more highly developed form of industry from England: the increase of manufactures in Britain under the magic influence of steam, the rapidity of turnover and the comparative cheapness of machine-made goods dealt a severe blow at the native crafts and industries.[1] The blow was reinforced by certain accompanying factors: the disappearance of the native courts deprived many of the industries of an active patronage;[2] the rise of a new educated professional class with different tastes, and hence with a different demand, accentuated the dislocation; and, to crown all, came the protective duties in Great Britain on certain manufactures from the East and these virtually

1 Gadgil: *op. cit.*, p. 42.

2 See, for example, S. M. Hadi: A Monograph on Dyes and Dyeing in the N. W. Provinces and Oudh (Allahabad, 1899). "The dyeing industry in Lucknow received its greatest impetus in the reign of Wajid Ali Shah, the last King of Oudh. On certain occasions admittance to the fancy fair at Kaisar Bagh was not allowed except to persons dressed in saffron-yellow garments...on other occasions the courtiers and their attendants were ordered to put on salmon-coloured dress before they could be entitled to the privilege of waiting upon His Majesty". (p. 3).

shut out from the Indian traders and craftsmen a very steady and profitable market.[1]

The decline of the indigenous industries and arts was thus primarily due to factors other than those of actual finance. It is debatable how far the growing weaknesses of the trade and craft guilds intensified the decline. Undoubtedly, capital and finance did not directly suffer on account of their weaknesses. It is more to the point to argue that the weakening of the powers of these bodies removed a very important force that regulated trade, maintained the quality of the materials produced and generally promoted the team spirit among the craftsmen and artisans concerned.[2] The actual decline of India's industries was due to quite different factors: the decline of guilds and similar bodies owing to the impact of Western politics and Western industrialism could only aggravate an already worsened situation—it could do nothing more than that.[3]

In one way, however, the matter of finance had important consequences on industries. This was the changed status of the indigenous banker. Simultaneously with the cessation of his rôle as a revenue collector or

[1] Cf. James Taylor: A Sketch of the Topography and Statistics of Dacca (Calcutta, 1840). A protective duty of 75 per cent virtually shut out Indian muslins from the British market. (p. 364).

[2] Gadgil: *op. cit.*, p. 46.

[3] It is very interesting to enquire into the causes of the declining power of these Indian guilds. Perhaps the same forces that caused the decline of the mediaeval guilds of England also helped to bring about the decline of the Indian bodies. The physical impossibility of maintaining a system of apprenticeship, defects in guild procedure, intensification of particularism, pronounced cleavage between masters and men and the general spirit of the age upholding free trade were responsible for the death of the guild system in England. And some of these factors could be applied to the case of India as well. See Stella Kramer: The English Craft-guilds (New York, 1927), pp. 187-205.

a state banker came the loss of much of his money-changing business; and the political insecurity of the times combined with internecine disputes dealt a great blow to internal trade and commerce, out of which the indigenous shroff had derived much of his profits. The decline of handicrafts and arts and the consequent poverty of the people compelled him to resort to more and more exacting terms for loans and advances.[1] The rapid accumulation of hoards owing to political troubles only accentuated his difficulties: in 1781, there was found in the strongholds of the Chief of Benares, a mere zemindar or collector of land-revenue, a sum little short of a quarter of a million sterling in precious metals after three expensive wars with the English and the loss of a great extent of territory; and in 1803, in one of the many strongholds of the Mahratta Chief Scindhia, there was found £330,000 in hard specie.[2] And the most unfortunate thing was that frequently these vast hoards contained enormous sums of money realised by the princes at the point of the sword from the indigenous bankers.[3] The result was that the banker of the old days had, of necessity, to degenerate into the rôle of an exacting money-lender: the general proverty of the artisans and craftsmen, the political insecurity of the times and the comparative dearth of his own available funds—all these combined to make his rates of interest high and his mode of advances exacting and severe. The picture has been admirably drawn by an anonymous writer of the early nineteenth century. "Every manufacturer and every artisan, working for his own account, conducted the whole process

[1] For details see L. C. Jain: Indigenous Banking in India (London, 1929), pp. 18-23.

[2] Sketch of the Commercial Resources and Monetary and Mercantile System of British India (London, 1837), p. 53.

[3] *Ibid*, p. 54.

of his art from the formation of his tools to the sale of his production. Unable to wait for the market or anticipate its demand, he could only follow his regular occupation as immediately called to it by the wants of his neighbours. In the intervals he had to apply to some other employment, and the labours of agriculture, ever wanted, were the general resource. The mechanick (sic), finding himself as fully competent as the constant cultivator to the management of common husbandry, was not discouraged from undertaking it at his own risk. Every labourer, every artisan who had frequent occasion to recur to the labour of the field, became a husbandman. Such farmers were ill qualified to plan or conduct a well-judged course of husbandry, and were idly employed, to the great waste of useful time, in carrying to market the paltry produce of their petty farms. If Bengal had a capital in the hands of enterprising proprietors who employed it in agriculture, manufactures and internal commerce, these arts would be improved: and, with more and better productions from the same labour, the situation of the labourers would be less precarious and more affluent, although the greatest part of the profit might rest with the owners of the money advanced."[1]

Contemporaneous writings are also full of references to the scarcity of capital and money, especially in Bengal: it was the outward symptom of the disorganisation that had overtaken both the politics and the economics of the country. Ghulam Hussain Khan, the historian of this period, describes the situation in these words: "The decrease of products in each district, added to the innumerable multitudes swept away by famine and mortality, still goes on augmenting the depopulation of

1 Remarks on the Husbandry and Internal Commerce of Bengal, pp. 45-46.

the country ; so that an immense quantity of land remains untilled and fallow and a vast number of industrial enterprise remains without money or a leader. And this is so far true that were it not for the purchase of saltpetre, opium, silks and white piece-goods which the English make yearly throughout Bengal and Bihar, probably a Rupee or an Eshreffi would have become in most hands as scarce as the Philosopher's stone......"[1] Says also Sir James Steuart in his treatise on money : "The complaints of a scarcity of coin in Bengal, once so famous for its wealth, are so general that the fact can hardly be called into question.......The revolutions of government in Hindostan, the ravages of foreign conquerors and domestic tyrants, have no doubt, on the one hand, carried off the treasures, as on the other they have interrupted the trade and industry of the inhabitants which for many ages had been the means of heaping them up."[2]

In an indirect way the decline of the old trade and craft-guilds was an accession of strength to the independent shroffs and *mahajans*. Just as in mediaeval England the weakening of the guilds was followed by the increasing power of the middlemen, so also it happened in India. Bankers and money-lenders, now relaxed from the obnoxious pressure of the community as expressed in meetings of the *panchayats* and guilds, could exercise their control of loanable funds with some rigid exactitude. In the vicious circle that was set up the *mahajan* was no longer a banker, an issuer of bills or receiver

1 Seir Mutaqherin (Tr. by Stewart), Vol. III, p. 32.

2 Sir J. Steuart : Principles of Money applied to the Present State of the Coinage in Bengal (1772), p. 56.

3 Stella Kramer : The English Craft-guilds (New York, 1927), pp. 184 *et seq.*

of deposits, to the extent which he had been, but he became only a money-lender and a pawnbroker;[1] his heavy rates of interest on advance of money coincided with the growing poverty of the people, and many industries and crafts, no longer in the old semi-monopolistic position, had to continue their operations under the greatest handicaps. Gradually, the craftsmen came to be entirely in the hands of money-lenders; and frequently it was the *mahajans* who supplied the raw-materials, and the workers got nothing but bare subsistence wages.[2]

While the indigenous industrial system was thus dislocated, new factors were appearing on the horizon of trade and industrial finance. These were the Agency Houses of the three Presidency cities (of which the Calcutta Houses were by far the most important) and the early European joint-stock banks. Of these the former dominated the mercantile and financial world till about the beginning of the second quarter of the nineteenth century. Now, previous to the year 1814, the East India Company enjoyed, by law, a monopoly of foreign trade, from the east coast of Africa to the west coast of America inclusive. As to internal trade, although the Company did not, for a great number of years, interfere in the local trade of the country, it meddled in the trade of staple articles and even prevented non-official Europeans from engaging in the inland corn, salt and tobacoo trades.[3] At the same time the restrictions on the residence

1 W. Hoey: A Monograph on Trade and Manufactures in N. India (Lucknow, 1880), p. 26.

2 N. G. Mukherjee: A Monograph on the Silk Fabrics of Bengal (Calcutta, 1903), p. 64.

3 Sketch of the Commercial Resources etc. of British India, p. 63.

of Europeans in India were severe and oppressive, Europeans being liable to expulsion for any offence given to the government. Such a system greatly paralysed the efforts of independent Europeans to promote Indian trade and industries; and while it is debatable how far this was to the ultimate good of India, there is no doubt that this greatly strengthened the monopolistic position that the Company enjoyed.[1]

It was under this system that the great mercantile firms of Calcutta sprang up. The partners of these Houses consisted, in many instances, of the civil, military and medical officers of the East India Company: these people entered them after quitting public service, attracted by the large profits that these Houses made. Now, although generally men of talent and acuteness, they were, for the most part, destitute of mercantile training and experience.[2] But as long as the East India Company's monopoly lasted, the great mercantile Houses were placed under circumstances which naturally secured to them a kind of sub-monopoly. Nearly the whole European business fell into their hands; they were the agents for the planters and merchants settled in the provinces; they were bankers receiving deposits, bankers making advances for the produce of the interior and, frequently, bankers issuing paper money. They made large advances on ships, shipments and indigo factories; and as general merchants, they not only acted as the agents of others, but speculated largely to every quarter of the world, on their own account. And, finally, by foreclosing mortgages on the

1 *Ibid*, p. 63.

2 Very often the partners retiring with fortunes to Europe set up mercantile establishments in London, so that each local firm had a corresponding firm in England, not exactly in partnership, but intimately connected with it in business, *Ibid*.

ruin of speculators to whom they had made advances and on ships, houses and factories, they became, eventually and to a very great extent, ship-owners, house-owners, farmers and manufacturers.[1]

As regards the capital of these Houses, the partners were often without any capital of their own at the outset; indeed the deposits from the savings of the civil and military servants may be said to have contributed throughout the principal funds with which their business was conducted.[2] These Houses also had extensive transactions with Indians which "answered the purpose of capital": they were not exactly partners in the business nor did they lend their capital collectively, but they had "*bona fide* transactions which, in their nature, answered all the purposes of capital."[3] In short, these firms had come to acquire a high prestige in the eyes of Indians and enjoyed the unbounded confidence of the great moneyed people of Calcutta as well as of many of the provincial towns.[4]

The fact should not be lost sight of however, that these Houses were established primarily with a view to promoting the Company's business. An intimate and friendly connection and intercourse has always subsisted between the great firms and the Company's servants who, before 1814, constituted nearly the whole European community. "Commanding their respect and friendship, with strong claims on the gratitude of many and possessing the unbounded confidence of all, it is little to be

1 *Ibid*, p. 64.

2 Evidence of R. Davidson before the Select Committee on the Affairs of the East India Company (1830), Cmd. 646.

3 *Ibid*. Davidson does not mention, however, what exactly these *bona fide* transactions were.

wondered at that the large annual savings of the servants of the government were poured in upon them—more especially after the great reduction which took place in the interest on investments in the public funds, and which, in seventeen years' time, had fallen from 10 to 5 per cent." It was a great advantage to mercantile enterprise that the savings of public officers, instead of being invested in public securities or remitted to Europe, came to a large extent into the hands of the Calcutta firms and continued in the country. Indeed, so high was their prestige that the civil and military officers even of Bombay and Madras invested their funds, to a considerable extent, in the Calcutta firms.[1]

With the large funds thus received by these great Houses in their capacity of bankers, they made advances to speculators for indigo, cotton, silk, opium etc. to the annual amount of full five millions sterling.[2] The interest which they allowed on deposits was generally not less than 10 per cent and that charged on advances 12 per cent besides a commission on the advances. Further details about these advances are lacking, but we can have a glimpse of some interesting features from the state of the indigo industry which was primarily a European concern. The average indigo planter or manufacturer of this period did not carry any capital to India; he had a large advance from the Agency Houses in Calcutta, paying an interest betweeen 10 and 12 per cent, and even on this interest he made a large profit.[3] The advances were, in most cases, secured by insurance of lives; it was very

[1] *Ibid*, p. 65. This was also due to the fact that the rate of interest was higher in Calcutta than elsewhere.

[2] *Ibid*, p. 66.

[3] Evidence of R. Davidson before the Select Committee on the Affairs of the East India Company (1830), Cmd. 646.

seldom the custom to enter into a joint security with the the manufacturer who borrowed the money of the Agency Houses.[1]

Side by side with these Agency Houses rose a new type of financial organisation—the early European joint-stock banks. Many of these so-called banks were, however, no better than virtual departments of some of the leading Agency Houses of the time: the Bank of Hindostan, established about 1770, was for instance practically a department of Messrs. Alexander & Co., and so also was the Calcutta Bank started by Messrs. Palmer & Co.[2] On the other hand, there were the real joint-stock banks like the Bengal Bank established (most probably) about 1784, or the General Bank opened in June, 1786. The establishment of these banks meant an encroachment on the monopoly of the Agency Houses; and the competition that ensued led to improvident advances, by both the banks and the Houses, to prodigal public officers of the government and to needy and ignorant private adventurers. Moreover, the year 1814 saw the first blow to the Company's monopoly of trade when large numbers of prudent and cautious traders began to pour into India from Europe. In the general scramble that followed the Agency Houses were deprived, to a large extent, of the ordinary mode of employing the large amount of deposits which still continued to pour in upon them and thus definitely entered upon their period of decline; many of the new banks also fared no better—improvident advances and speculative dealings affected their soundness and credit as well, and quite a number went into liquidation during the general crisis of 1830-32.

1 Evidence of George Harris, *Ibid.*
2 H. Sinha: Early European Banking in India (Calcutta, 1928), pp. 4-5

It is this crisis that marked the apogee of the prosperity of the Agency Houses. The whole story is of exciting interest and not without important lessons for the student of banking and finance. The collapse started with the active competition of more enthusiastic and economical traders from about the year 1814 when the first blow to the Company's monopoly of trade was given. The Calcutta Houses had already got into the habit of making speculative advances—advances to private adventurers who recklessly entered into any sort of speculation and who even obtained additional advances in order to extricate themselves from the difficulties in which their rash transactions had already involved them. "The balances against the speculators, increased by heavy interest charges, were yearly brought to the new books of the establishment as if they were real assets, until death either reduced the amount, by recovery of the sum insured on the life of the party, or cancelled the debt, when no insurance had been effected."[1] All these dangers were intensified by the new competition which deprived the fiirms, to a considerable extent, of the ordinary mode of employing the large deposits which still continued to pour in upon them. The Agency Houses began to resort to new and more precarious forms of investment. Tempted by temporarily high house-rents in Calcutta, they invested largely in houses; they also invested largely in indigo-works, coal mines, ships and ship-building, breweries, tanneries, distilleries, spice and coffee plantations, clearing desert islands etc., and even in cotton mills, rice mills, flour mills and saw mills. The value of these rose in proportion to the influx of capital: in this manner was locked up a great share of their funds which, when the crisis arrived,

1 Sketch of the Commercial Resources etc. of British India, p. 67.

could not be realised except at most ruinous sacrifices, such funds being practically unavailable to meet the firms' obligations.[1]

Still, such was the unlimited confidence reposed in them by the Indian community that for a considerable time to come they began to receive deposits as usual.[2] This, however, only increased hazardous speculations: more and more money was advanced to indigo planters without any capital of their own; goods were exported to China, Europe etc., either directly on their own account or indirectly by lending largely on the security of the goods to those who did export; interests were purchased in Indian shipping and many other speculative investments of this kind were made. As might be expected many of these speculations turned out exceedingly ill. The cultivation of indigo was so much increased that its price gradually fell to a level at which it would not pay even the bare expenses of production; the investments in Indian shipping turned out even worse than those in the indigo plantations, the shipping of England having nearly driven that of India out of the field; to crown all, several of the partners of the various Houses returned to Europe taking large sums with them as their share of the capital of the firms. "The embarrassment produced by this locking up of their capital, by the withdrawal of portions of it to Europe and by the unfavourable termination of many of the adventures in which they had engaged, began to manifest itself simultaneously with the scarcity of money occasioned by the drains on account of the

[1] *Ibid*, p. 67.

[2] Even the failure of the Palmer & Co. in 1830 did not affect the remaining House so immediately, as was at first apprehended, owing to the good assets of that House. *Ibid*, p. 68.

Burmese War."[1] The big House of Messrs. Palmer & Co. failed in 1830 and although it did not lead to an immediate panic, public confidence had been shaken, deposits were rapidly decreasing and the depositors whose balances had accumulated had begun gradually to retire them. Even then the firms went on borrowing funds at heavy sacrifices by pledging every description of property within their power. So came the crash : these great Houses, which had been the principal channel of conducting the export and import trade of India for half a century, failed, one after another, in the course of three short years (1830-33), and in the aggregate, for the enormous sum of twenty millions sterling.[2]

The failure of these Agency Houses pointed to the fundamental lack of equilibrium in the economic position of the country. While there were vast sums of available funds in their hands, there were no adequate opportunities for investment at all. The whole political situation was in a flux ; economic lifeh ad been disorganised by the impact of machine-made products from the West as well as by the weakening of the indigenous economy ; and while old industries were dying, few new ones (except perhaps the indigo industry) were taking their place. On the other hand, both the Agency Houses and the early European joint-stock banks had been confronted with the problem of how to employ their capital as well as deposit resources. They could employ them only in the discount of approved bills at short dates, in the granting of cash credits or in the

[1] Reasons for the Establishment of a New Bank in India (London, 1836) by an anonymous writer, pp. 13-14. The only available copy of this book is in the Guildhall Library, London, to which I was given access through the kind courtesy of the Librarian.

[2] Sketches etc., *Ibid*, pp. 68-69.

purchase of Government securities readily convertible into money; but mutual competition and the desire to make high profits led them to indulge in all sorts of adventurous speculation. Besides being bankers, they became merchants, and sometimes also indigo-planters and ship-owners. This vicious combination coupled with the fact that there was no effective area for safe but profitable investment of all the available surplus was primarily responsible for the ruin that overtook these great Houses of finance and banking.[1]

We should now turn our attention to the real joint-stock banks that flourished about this time.[2] It was logical and proper that, in the disturbing economic and political atmosphere of the day, these banking houses should be hedged with restrictions with regard to the employment of their capital. The Bengal Bank was rightly enough not permitted to engage in any commercial concerns except the purchase of bullion; and though Mr. C. Cockerell's minute of dissent attributing the contemporary *batla* (premium) on gold mohurs partly to the establishment of the General Bank went too far, the general policy of the bank was sound and was commended by all observers and experts.[3] As the plan of the Bank showed, it was "established for the purpose of general convenience, and in some measure to alleviate the distress caused by the general scarcity of money which India had long laboured under and which had operated to the great disadvantage of the public and of indivi-

[1] Reasons for the Establishment of a New Bank etc., p. 13.

[2] See *supra* for a distinction between the "real" joint-stock banks and the "so-called" banks which were no better than virtual departments of some of the Agency Houses of the time.

[3] Report of the Harris Committee (1787).

duals, and in the hope of lowering the heavy discount which the Treasury orders and other paper issued by and on account of the English East India Company had long borne, to the great loss of individuals, and operating to the annihilation of all trade and commerce throughout British India."[1]

Criticism has sometimes been levelled at these banks on the ground that they did not go far enough for the development of the country's trade and industries, that they teemed with too many restrictions and that they were generally conservative in outlook. Now, we should not overlook certain fundamental factors in the situation. Firstly, there were no adequate opportunities at all for suitable investments. Old industries had decayed owing to factors over which banking houses had no control, while new ones were scarcely rising. Even in the solitary case of the indigo industry, the planters and manufacturers (who, it should be remembered, had often little or no capital of their own) were more than overflooded with the advances from the Agency Houses—so much so that in 1801 they refused a special loan proposed by the Bengal Government. Mr. Alexander Nowell, an indigo-planter wrote: "I admit our poverty......Nay, I will admit further, that the capital offered to us by means of the loan is far more advantageous to us, I mean the terms of it, than any funds we can otherwise obtain. But it is this very circumstance, this apparent solecism, the facility of this loan, causing sudden and uncommon extension of the manufacture beyond all possible demand, that will ultimately be far more injurious to us than the loans

[1] W. S. Seton-Kerr: Selections from the Calcutta Gazette, 1744—88 (Calcutta, 1864).

supplied by the Houses of Agency even."[1] Thus it is nonsense to speak of financing industries when there were few industries to finance.

Secondly, we should not forgetthat in those prevailing circumstances, political and economic, the first duty of a bank was to induce economic stability through a reasonable issue of notes, discount of sound bills and commercial paper, and the provision of suitable opportunities for the accumulation of savings. Judged by these tests, the banking houses of the time on the whole performed their duties very well ; their function was not to indulge in rash speculative ventures of doubtful economic utility. The grim consequences of the rash ventures of the Agency Houses should be an eye-opener to all critics.

This general defence of the policy of the banking institutions does not mean, however, that there were no room for improvement. The economic disequilibrium in the sphere of industrial finance manifested itself in two ways. On the one hand, the indigenous bankers had lost their old pre-eminence on account of the decline of industries and the passing away of a good deal of internal trade as well from their hands to those of the servants of the Company. On the other, the new joint stock banks and Agency Houses, conducted on European lines, confined their operations mainly to the financing of external trade ; and even when they tried to help internal trade and industries, they found themselves treated with suspicion and distrust by the indigenous shroffs and *mahajans*[2]. This exclusiveness

1 House of Commons Papers, 1812-13, Cmd. 336.

2 Sinha : *op. cit.*, pp. 38-60.

of these new agencies of finance was perhaps inevitable: at a time when the free merchant was an eye-sore because he interfered with the profits of the Company's servants in trade, when the members of Government up to the President himself were allowed to trade, when even chaplains and doctors had a share in the profits of the salt monopoly, we cannot of course expect the financing houses to devote themselves to any purpose other than the immediate profits of external trade.[1] External commerce competed with internal needs for the trading capital of these banks, but as the former was at a premium, the latter had to be somewhat neglected.

We shall, however, be flying in the face of facts if we assert that the problem had not presented itself to the new rulers of India. While Ghulam Hussein Khan was rightly attributing the dislocation to "the gates of communication and intercourse having been shut up betwixt the men of this land and those strangers who are become their masters,"[2] Sir J. Steuart pointed the way out of the difficulty. He pleaded for the establisment of a Bank for extending circulation by means of paper credit and he wanted to incorporate the indigenous system inside the new English one. "What a new phenomenon in Bengal," he said, "a shroff director of a bank from a blood-sucker is become the protector of the labouring men! Interest does it all. He sucks the blood because it is his interest so to do. He gives his protection from the same motive. By directing the interest of individuals to a proper

[1] Rev. J. Long: Selections from the Unpublished Records of Govt. for the years 1748-67 (Calcutta, 1869), pp. xxvi-xxvii.

[2] Seir Mutaqherin (Tr. by Stewart), Vol. III, p. 155.

object, good government is established."[1] And this was in 1772! He recognised that it was the foreign trade of Bengal alone which could increase her wealth, or at least "keep the cistern full in spight (sic) of its many leaks"; and by the foreign trade of Bengal he meant the raw-materials for manufacture and the manufactures themselves. And he concluded: "That the manufactures of Bengal need encouragement is certain, since the quality of goods is said to be inferior to what it was some years ago, while the prices are higher and the supply less. This never can be the operation of trade. This is due to internal dislocation."[2]

But it took some time for such admonitions to become practical politics. The essential need of the hour was the establishment of a link between the business centres of the interior and the mofussil and the Presidency towns, specially Calcutta. The few European joint-stock banks that flourished had no branches in the up-country and a concerted policy of maintaining links through branches at important centres could only be achieved through the establishment of a general bank under government patronage.[3] Although an attempt was made as early as April, 1773 to establish an indigenous bank under government patronage the bank had not proved a success and been short-lived.[4] It was only in 1806

[1] Steuart: *op. cit.*, p. 79.

[2] *Ibid*, p. 82.

[3] Cf. Sinha: *op. cit.*, pp. 60-65.

[4] J. C. Price: Notes on the History of Midnapore (Calcutta, 1876), Vol. I, pp. 201-02. The object of this bank was to ensure "the greatest utility and convenience not only to the Company in drawing the receipts of their revenues from the out districts to the Presidency, but also to private merchants in making their advances to the *aurangs* (i.e. places where goods are manufactured for sale) and otherwise in facilitating and rendering secure the course and circulation of their trade."

that the Government's efforts matured in the shape of the Bank of Calcutta, the first and nearest approach to a Government Bank. Established with a view to "securing general utility to the public without incurring any risk and without the smallest inconvenience", it got its Charter in 1809 when it was re-named the Bank of Bengal. It would be rash to say that this was a new departure or the dawn of a new era ; but it certainly was an important landmark in Indian banking history in as much as it paved the way for a possible restoration of the economic equilibrium.

CHAPTER IV

BANKING AND INDUSTRIAL FINANCE DURING THE FIRST HALF OF THE NINETEENTH CENTURY (1806-1860): THE GRAND PROJECTS OF 1836 AND 1840

The Bank of Calcutta was established in 1806, and, though it did not get its Charter until 1809 when it was transformed into the Bank of Bengal, the date of its establishment was an important landmark in as much as it paved the way for a greater government control of, and interest in, banking and investments. The economic fabric of the country had been shaken by the factors analysed in the previous chapter, and the co-operation of the government was vitally necessary if any equilibrium was to be attained in the agricultural and industrial spheres. Although no high sounding efforts could be made by way of actual participation in industrial finance (for reasons to be analysed hereafter), the establishment of the new Bank under government patronage led to a better investing habit and facilitated the grant of loans to individuals. The issue of Bank notes was a great convenience to the Treasury: most of the payments of the government (excepting the pay of troops) began to be made in Bank notes[1] and these were also allowed to be received in payments at the public Treasuries in the interior of the country.[2] In another

[1] Bengal Financial Letters and Despatches (India Office Records), Vol. I, 1807-08. (Mss.)

[2] *Ibid.* They were not to be issued, however, from the mofussil treasuries unless the persons who had demands on these treasuries preferred them to cash.

way also the new Bank could afford beneficial accommodation to the public. "Previous to its establishment many individuals possessed of Company's paper had, on an emergency, no other mode of raising money but by the sale of that paper......Now, by depositing their paper with the Bank they could obtain funds without subjecting themselves to that inconvenience......and this was attended with beneficial effects on public credit and tended greatly to keep up the price of public securities."[1]

An analysis of the quantitative aspect of the accommodation afforded by the Bank throws some light on the general state of banking finance at this time. The Bengal Financial Records and Despatches, however, give very incomplete accounts and the general impression left on the mind of the reader is that the Bank's loans were marked by great fluctuations from year to year at least during the first decade of its establishment. In July and August of 1807, for example, the applications to the Bank for loans were "so frequent and to so large an amount" that they could be complied with only in part, but in the next two months hardly a single application was made to the Bank for a loan.[2] In 1808 the Bank reduced the interest of its loans from 10 to 9 per

1 *Ibid.*

2 *Ibid.* The Bengal Government wrote to the Home authorities: "As the profits of the Bank are in a great measure derived from lending its surplus cash to individuals, the accumulation of so large a sum (about 30 lakhs of Rupees which is nearly equal to the amount of its notes in circulation) in the Bank, without any means of employing it to advantage, would of course be attended with considerable loss to the proprietors. We deemed it, therefore, to be advisable, with a view to obviating further loss to the Bank as well as relieving our Treasury from the pressure of the heavy demands on it during the past and present month, to direct our Accountant-General to inform the Bank Directors that if they would withhold their demands on our Treasury during those months, interest would be allowed them at the rate of 10% until the arrival of the treasure from Bombay and the realisation of the balance of the last salt sale and the collection on account of Land Revenue etc. in the ensuing month of December should enable us to discharge the amount due to the Bank."

cent, but the application for loans was still very inconsiderable.[1] There was, however, a remarkable change very soon after: the fifth volume of the Bengal Financial Records speaks of the "unquestionably very considerable demands of the principal mercantile houses" which had no other means of meeting the pressure but by disposing of their Government securities in the open market. The Bank of Bengal, we are told, could no longer accommodate them with loans, having already advanced to the utmost extent which by its Charter it was authorised to do and so the merchants were compelled to meet the emergency by disposing of their paper although this forced sale of government securities had extremely prejudicial effects.[2] A few years later still the demand of the commercial community increased to such an extent that the Bank of Bengal found it necessary to raise its rate of interest "for the purpose of checking the applications for discounts and accommodations," although the Directors had found that they could not employ all the capital of the Bank at the higher rates of interest.[3]

Now, for years together, the Bank of Bengal practically dominated the Indian money-market. The Bank of Madras was not established until 1843 and the first Bank of Bombay until 1840; and so the only real rivals were some of the principal Agency Houses and, from 1829 onwards, the Union Bank of Calcutta. We have seen in a previous chapter, however, that these Agency Houses came to grief in 1830-32 as a result of hazardous speculation, and for a considerable time

1 *Ibid*, Vol. 3, 1808-09 (Mss.).

2 *Ibid*, Vol. 5, 1811-12 (Mss.).

3 *Ibid*, Vols. 7 & 8, 1813-14 & 1814-15 (Mss.).

to come the void left by these houses of business and finance could never be filled up, partly perhaps due to the jealousy of the East India Company and the Bank of Bengal, but mostly due to such factors as the absence of suitable avenues of investment, the lack of available capital inside the country and the general need for caution and security in the promotion of new enterprises.[1]

Although attempts to establish separate banking institutions frequently came to nothing on account of the causes mentioned above, it would be unfair to the Bank of Bengal to suggest that it did not recognise the growing demands of the commercial and business community. Even as early as 1822 the President and Directors of the Bank were proposing alterations in the Charter and carrying on correspondence with the Court of Directors in England on the expediency of increasing the capital stock of the Bank.[2] "The amount fixed in 1806 (50 lakhs) did actually exceed the amount that in 1806 could find profitable employment in banking business, and much of it was subscribed in public securities bearing interest; moreover, a period of commercial stagnation ensued in 1809 and 1810 and the real demand for accommodation was for a time inconsiderable. But not long after the opening of trade[3] gave a new commercial character to Calcutta and since this era it has not infrequently occurred that the community have suffered inconvenience from the inability of the Bank of Bengal to afford accommodations to the extent required: not that the real demand for accommodations

1 Cf. A.S.J. Baster: The Imperial Banks (London, 1929), Ch. I.

2 Bengal Financial Letters and Despatches, Vol. 14, 1822-23 (Mss.)

3 The obious reference is to the removal of the Company's monopoly of India trade by the Charter of 1813.

has been uniform, for often funds could not be employed, and great fluctuations still continue to characterise commercial proceedings in this country. Our experience, however, of the state of things for sometime past, not only as it respects our own Bank but other banking establishments in Calcutta, whose very existence indeed is some evidence that our means of accommodation are too limited, has satisfied us that we are not premature in now soliciting an increase of our capital stock to the extent above mentioned (i. e. to 100 lakhs)."[1] As further ways of easing the stringency, the President and Directors also suggested that the amount of cash in actual possession of the Bank should be one-fourth instead of one-third of the liabilities, and that all limitations to loans on deposit (except that of time, which was 3 months) should be removed.[2] But the Government of the day did not look upon the Bank's proposals with much favour; they approved of the retaining of one-fourth cash instead of one-third, and did not oppose some minor modifications, but on the major issue of increasing the capital stock of the Bank their decision was emphatically in the negative.[3] The Government contended that the proposals of the Bank would mean overissue of notes and depreciation of currency, and as the Bank had been established, first and foremost, to enable the Government

1 *Ibid*, Letter from the President and Directors of the Bank of Bengal.

2 *Ibid.*

3 *Ibid*, Vol. 15, 1823-25. (Mss.) It is interesting to note in this connexion that the restriction prohibiting the issue of notes to an extent exceeding the capital stock of the Bank had its origin in a letter from Mr. Tucker to the Marquis Wellesley (14th July, 1801). "This restriction was borrowed from the plan of the Columbia Bank and it appears to me a very salutary rule in as much as it prevents all infinite risk and provides for the security of both the Proprietory and the Public."—Observations of the Accountant-General (Govt. of India) on the Bank of Bengal's proposals. *Ibid*, Vol. 14,

to withdraw from circulation a depreciated currency which embarrassed all its operations and was productive of infinite inconvenience and injury to the public and which purpose had been admirably achieved, they did not want to embroil themselves in something too bold and hazardous—viz., the increase of capital stock by a hundred per cent.[1]

A new charter was granted to the Bank of Bengal by the Government of India on these limited lines in 1823.[2] In 1826-27, however, there was another scarcity of capital in the country, during the greater part of which the Bank was of little aid to the merchants owing to the fact that its issues very soon reached the proportion of its cash prescribed by the Charter, and further discounts were then of necessity stopped. And the state of the Government Treasury and the demands thereon, expected or eventual, prevented the Government's parting with any funds to aid the Bank, as had occasionally been done before this.[3]

In all this there was a sort of tug-of-war between a policy of cautious and careful advances on the one hand and one of forward movements and bold risks on the other. This struggle manifested itself not only in the exchange of correspondence between the Court of Directors and the Bank of Bengal, but also in the general reaction of all

[1] *Ibid*, Vols. 14 & 15, 1822-23 and 1823-25 (Mss.).

[2] It is an interesting commentary on the attitude of the Court of Directors in England that a long controversy raged between the Home and Indian authorities for a considerable time to come "on the illegality of the grant of a new Charter to the Bank of Bengal by the Government of India without the Court's permission." The Court wanted the Bank to go back to the old position, but eventually confirmed the Charter in 1829. *Ibid*, Vol. 19, 1827-28. (Mss.).

[3] *Ibid*, Vol. 18, 1826-27. (Mss.).

interests to any new proposals made for the the extension, development or modification of banking enterprises. The years 1836-42 are marked by strenuous efforts on the part of British investors to establish two big general banks[1] for the whole of India : in the end both the projects fell through, but the controversies and criticisms they provoked throw a very important light on the general state of banking finance about this time.

The first project came up in 1836 : it was a project for the incorporation of an Anglo-Indian bank of an altogether unprecedented size and scope, and its subscribers were unusually large in number and persons of influence.[2] In the words of a contemporary supporter of the project, "influenced by these views (viz., the very considerable advantages of banking finance) and desirous also to open a safe and advantageous channel for the employment of a portion of the redundant capital of this country (i.e. England), a number of gentlemen resolved, provided they obtained a Charter from the Crown and the sanction of the East India Company, to establish a Bank in India, on a scale commensurate with the wants of that great division of the Empire, and with a capital sufficient to guarantee the most undoubted stability."[3] The Bank was to have a capital of £ 5,000,000 consisting of 50,000 shares of £ 100 each: the chief office was to be in London, management being vested in a Board of twenty four directors ; and management in India was to be confided to a Board of Directors at Calcutta with subordinate Boards at Bombay and Madras and at other places where branch banks might be established. The time chosen was

1 A General Bank for All India project of 1836 and the Bank of Asia project of 1840.

2 Baster, *op. cit.*, p. 88.

3 Reasons for the Establishment of a New Bank in India (London, 1836).

most propitious : the Agency Houses had almost all succumbed to the crisis of 1829-30, the Bank of Bengal suffered from great commercial handicaps in spite of the advantages of a Government connexion, and the only probable rival was the Union Bank of Calcutta, established in 1829, but a bank with a small capital and without a charter. The Bank of Bengal was, however, a jealous watch-dog of the needs and interests of India, and the East India Company with its commercial interests interlinked to the Bank of Bengal could hardly be expected to subscribe to "a proposal mooted by certain general merchants in London" without a thorough and searching examination of its details.

The proposed Bank had, as its avowed objects, an extensive remittance transaction between the Presidencies and England and China, embracing, with ordinary banking, business of the government.[1] The proposal was referred by the Indian Government to their financial experts, and very soon the keen insight of Mr. T. H. Prinsep (Financial Secretary to the Government of India) and other officials and the searching analysis of Mr. Fullarton exposed the fallacies and defects, both fancied and real, of the whole grandiose scheme.

The main arguments levelled against the proposal were threefold.

First, the combination of remittance operations with ordinary banking business was held to be dangerous and unsafe. "I protest against all stock-jobbing speculations or general agency dealings even for Government," wrote Mr. Prinsep, "or remittance operations involving any risk."[2]

[1] Bengal Financial Letters and Despatches, Vol. 56, 1837 (Letter No. 2 of 1837) (Mss.).

[2] *Ibid*, Vol. 56, 1837.

Secondly, it was pointed out that there was no real demand for the vast sum of capital that the proposed Bank would like to invest. Mr. John Fullarton wrote in his memorandum: "I am not aware of any facilities which could be prudently or safely afforded to the mercantile community or which are afforded by chartered banks under similar circumstances that are not provided for by the amended charter of the Bank of Bengal as it already stands."[1]

And here came the third and the crux of the arguments. With an elaborate mastery of details and figures it was put forward that the Bank of Bangal, after the amendment of the provisions in its charter in 1836,[2] was quite capable of meeting all emergencies, so that the proposed Bank would only be a superfluous addition to an existing institution without bringing in any corresponding advantages. While some officials[3] were prepared to recognise that "the Bank of Bengal had not pushed itself sufficiently forward and had not yet made the most advantageous use of the means already at its disposal," the general consensus of opinion was that what was needed was not a new and separate institution like the proposed General Bank, but further modifications in the charter of the Bank of Bengal so as to make room for better efficiency and greater elasticity.

It is rather difficult for us to judge how far these objections were prompted by principles of sound banking and finance. Undoubtedly "the commercial interests of

1 *Ibid*, Memorandum by Mr. John Fullarton.

2 Act No. XIX of 1836 amended the Charter of 1823. Its main provision was to increase the capital stock of the Bank to 70 lakhs of sicca rupees. *Vide* House of Commons Papers (1860), Cmd. 53.

3 E.g., Mr. J. A. Dorin, B. F. L. & D., Vol. 56, 1837.

the East India Company were inextricably dovetailed with the interests of the Government bank."[1] But it would be rash to run to the sweeping conclusion that it was asking too much to expect an unbiassed opinion on the new scheme from a body of men whose interests might be imperilled by an amalgammation and would certainly suffer from competition.[2] A study of the various notes and memoranda shows that the opinions of such experts as Mr. Prinsep, Mr. Dorin and Mr. Fullarton were based more on principles of sound banking and finance than on any alleged bias or self-interest.

Undoubtedly, the project of a General Bank for all India, as it stood on paper, was grandiose and over-ambitious.[3] A General Bank for all the Presidencies of India and for China with a Board of Directors managing its affairs from London and dealing with the extensive remittance transactions of the East India Company might have contributed towards keeping exchanges steady and stable, but it was pertinent to ask whether a combination of vast exchange transactions with business finance proper and the management of Government debt and Government revenue would not have been unwieldy and top-heavy. Further, the contention of the promoters of the General Bank that it would be better able to help the Government in times of political difficulty was contrary to all notions of sound banking,[4] for, as Mr. J. A. Dorin pointed out, "the vital principle of a sound bank is that its returns should be regular and rapid......and if a bank lends its funds to Government in times of political difficulty,

1 Baster, *op. cit.*, p. 93.

2 Baster, *op. cit.*, pp. 93-94.

3 Mr. Prinsep described the whole project as "visionary and chimerical." Bengal Financial Letters & Despatches, Vol. 56, 1837. (Mss.).

4 Undoubtedly this was thrown out as a sort of bait to the Government.

which in other words means at a time when Government has no money and no prospect of repaying its debts, it has little chance of being solvent and having funds available for the purpose of the merchant where its services are principally required."[1]

The Government's second argument that there was no real demand for vast sums of capital in the country was also true. In 1814-15 the Bank of Bengal had to raise its rates of interest for the purpose of checking applications for speculative discounts and accommodations; and the general grumble of merchants and traders was the outcome of expecting too much from Government and the latter's refusal to accede to any and every demand for a loan.[2] Even as late as the twenties of of the nineteenth century the Bank of Bengal had found it difficult to invest a major part of its available surplus in profitable industrial and commercial ventures. During 1809-22, for example, only a small percentage of the employable funds could be used in discounting private bills; there was a large cash balance and vast sums had to be invested in Government paper (Company's Loan Paper).[3] The actual state of affairs was further elaborated

1 *Ibid.*

2 *Ibid*, Vol. 8, 1814-15. (Mss).

3 *Ibid*, Vol. 14, 1822-23. (Mss.) The general average of the state of funds during the period 1809-22 was this :

EMPLOYABLE FUNDS.	Sicca Rupees.
Capital ...	50,00,000
Bank notes outstanding	43,54,000
Lotteries, Premium and miscellaneous sources	3,35,000
TOTAL ...	101,89,000

EMPLOYMENT.	Sicca Rupees.
Cash Balances ...	28,96,000
In Company's Loan Paper	37,68,000
Treasury notes ...	8,09,000
Loans to the public on deposit ...	17,28,000
Bills discounted ...	9,88,000
TOTAL ...	101,89,000

by Mr. Prinsep in his memorandum to the Government of India. Up till 1822 the Bank of Bengal had, on the average, invested in Government securities Sicca Rupees 45,65,188 and in loans upon the deposits of Govt. securities Sicca Rupees 15,84,929 : its main profit was the interest derived from the sixty lakhs of rupees so invested. "Not that the Bank ever refused to discount a good bill; on the contrary this was the business done at the highest rate of interest—subject only to the limit of one lakh to one firm or one individual which was more nominal than real, the Bank having always desired to push its discounts."[1] As a matter of fact, there was no intense public demand for loans or discounts.

The position showed signs of improvement after 1822. Although loans on deposit averaged only 15 lakhs up to 1822, they were between 20 and 30 lakhs during

The figure for "bills discounted" included Government and salary bills which formed approximately 60% of the total amount of bills discounted!

A statement of the profits of the Bank of Bengal during the same period makes the oddness of the situation clearer still :

GROSS PROFITS.	Rs.	As.	P.	
From interest on Capital vested in Government Loan Paper	4	13	1	%
,, ,, Treasury Notes ...	0	15	4	,,
,, on Loans to the Public	2	8	6	,,
,, Private bills discounted	0	14	11	,,
,, Government Bills	0	3	10	,,
Profit and Loss miscellaneous	0	10	6	,,
Salary Bills	0	1	3½	,,
TOTAL RS. ...	10	3	5½	%

DEDUCT.	Rs.	As.	P.	
Charges General ...	0	10	1	%
Law charges ...	0	0	4	,,
Profit & Loss ...	0	6	7	,,
Unavoidable difference	0	1	0	,,
	1	2	0	%

	Rs.	As.	P.	
Deduct	1	2	0	%
NET PROFITS RS. ...	9	1	5½	%

[1] Note by Mr. T. H. Prinsep, *Ibid*, Vol. 56, 1837 (Mss.).

the last ten years of that period, and between 1822-28 they averaged upwards of 60 lakhs : and the average of the year 1835 was 73 lakhs.[1] But Act No. XIX of 1836 had increased the capital of the Bank to 70 lakhs of Sicca Rupees, and experts like Mr. Fullarton were undoubtedly right when they asserted that the new circumstances had not had a fair trial so as to enable them to give an impartial judgment on the need for a more extensive banking establishment like the proposed General Bank.[2] To the proposal, therefore, for the transfer of the Treasury balance to the projected Bank the answer of any far-seeing banker could only be an emphatic negative. Mr. Fullarton had before him the figures of the Bank of Bengal and he compared the proposed state of affairs with the existing investments by applying the figures to the Bank of Bengal.[3] Under the existing system, explained Mr. Fullarton with the help of 1835 figures, there was available for investment a sum of Sicca Rupees 187,19,512 ; the actual addition to the resources of the Bank from the transfer of the Treasury balance would be Sicca Rupees 109,42,639. Allowing for proportionate cash reserves on account of the increased amount of employable funds, the new project involved an addition of Sicca Rupees 45,04,733 to the existing resources of the Bank of Bengal ; and the problem was how to find a suitable avenue of employment for this surplus. On a solution of this rested the *rationale* of the projected new Bank.

Now the general opinion was that even the Bank of Bengal, not to speak of the projected General Bank,

1 *Ibid.*

2 Memorandum by Mr. John Fullarton, *Ibid.*

3 *Ibid.*

would not be able to find suitable fields of investment for the extra funds available. The proportion of the Bank assets which it had been practicable to employ in loans and discounts rarely exceeded a crore of rupees and there was no likelihood of an increase in the demand for this species of accommodation by a further augmentation of the Bank funds. "I am not aware," wrote Mr. Fullarton, "of any facilities which could be prudently or safely afforded to the mercantile community or which are usually afforded by Chartered Banks under similar circumstances, that are not provided for by the amended Charter of the Bank of Bengal as it already stands. Lend without security or discount without due regard to the credit and circumstances of the parties, and your issues might no doubt be enlarged to any amount. But even reduction in the charges of interest could scarcely of itself produce any frequent or effective increase of discount business; the utmost result of such a measure would be merely some temporary accession of custom, continuing till the charges of other similar establishments would be brought down to the same level and no longer."[1] Here he came to a most important point which most enthusiasts had lost sight of. Following the logic of the English banking system, he declared that it was not the duty of a great national bank with an overpowering command of capital to take the lead in forcing down the current rate of interest below its natural standard. The rule of the Bank of England was, he explained, rather to follow the indications of the money market than seek to influence them; she abstained from all direct competition or interference with the discount business

[1] *Ibid.*

of the private banks and held up her rate of interest rather a fraction above the market rate, but always in readiness to pour her resources into the field whenever any great crisis demanded her interposition.[1]

In all such circumstances only Government securities could be the best means of investment for the new funds. But this would not help industry and trade; nor could Government securities be regarded as absolutely safe, for, the stability of any bank having vast sums locked in Government paper might be endangered by its depreciation.[2] In spite of the robust optimism and zealous enthusiasm of the mercantile and manufacturing classes, the cold truth was that there were no great avenues for the employment of a vast banking capital in the India of this period. The instances of places like Agra and Benares, two mofussil cities of great commercial and manufacturing importance, proved this beyond a shadow of doubt: in the former place flourished the newly established Agra and United Services Bank,[3] but there were no suitable opportunities for the investment of its money in local commerce and industries. About the latter half-year of 1836-37, for example, out of an invested capital of Rs. 11,78,513, no less than Rs. 7,15,410 was employed in loans (for terms generally of 12 or 18 months) to members of the King's and Company's services, a sum of Rs. 1,51,800 was laid out in Government securities and about as much more advanced to individuals in cash accounts on mortgage or personal security. Of the entire

1 *Ibid.*

2 *Ibid.*

3 This was established in 1833, "to a certain extent on the debris of the Agency Houses". Cf. C. N. Cooke: The Rise, Progress and Present Condition of Banking in India (Calcutta, 1863), p. 204.

sum only Rs. 13,346 appeared to have found employment in discount, and most of these discounts were of salary bills![1] And such a business could scarcely be called banking![2]

These facts and figures serve to strengthen the third and the main argument of the Government, viz., that the Bank of Bengal with its amended Charter of 1836 was more than capable of meeting the financial needs of the country.[3] It was silly to argue that more capital was needed when there was no effective demand even for the existing funds. The plain fact was that there were no great opportunities for the investment of capital in manufacturing or business enterprises, for, such undertakings were still in their embryo. If the utility of a bank were to be measured by its accommodation to the public, the Bank of Bengal did not fall very short of a high standard at least during the first half of the century. There were imperfections no doubt, and the Directors of the Bank themselves admitted that "the present state of the Bank would admit of considerable extension" and expressed their readiness to lend their aid towards the extension of banking facilities in the interior "whenever the Government might indicate a desire to see

1 Memorandum by Mr. Fullarton, B. F. L. & D. Vol. 56, 1837 (Mss.).

2 Mr. Fullarton also records another of his personal experiences. Some eighteen years back he attempted to establish a branch of the Bank of Hindostan in the Rajshahi district in Bengal. The locality was a bad choice: nevertheless, the failure was too colossal to be attributed merely to the locality Beyond cashing the drafts of some of the indigo-planters of the neighbourhood on their Calcutta agents, it never, from the day of its institution, did any banking business, for *there was none to be done.—Ibid.*

3 In 1838, however, an Act was passed repealing Sec. III of Act XIX of 1836 together with its other provisions prescribing or implying that the capital stock of the Bank should not exceed 70 lakhs of rupees. But this repeal of the restrictive principle was not attended with any immediate increase of the capital stock. (Act. No. XXIV of 1838).

this measure acted upon."[1] But, on the whole, the Bank of Bengal was sufficient with its existing funds for the needs of the businessmen and entrepreneurs of India.[2] The Government did not dispute the contention that much could be done for the prosperity of the country by the gradual diffusion of the banking system. But they recognised that "capital must be more concentrated and new habits of business acquired and fostered *before* the facilities which banks are capable of affording could be turned to much account." The foundation would be most securely laid if left to the sagacity and caution of individual enterprises. Moreover, some of the very great impediments to the creation of branch banks about this time were the distances and the imperfect state of communications, the want of an intelligent and interested public to observe and check abuses, and the difficulties of superintendence.[3] Unless and until attempts were made to surmount these difficulties, big schemes, however ambitious and well-meaning, could do nothing to cure the real ills of business and industry.

In these circumstances the project of 1836 fell through : but four years later it reappeared in the Bank of Asia project with objects similar to those of the proposed General Bank. In a way this was far less ambitious in its proposed activities ; it did not undertake to provide a *complete* Home remittance service for the East India Company nor did it make the mistake of proposing to manage the Government Treasury or the

1 Observations of the Directors of the Bank of Bengal, *Ibid.*

2 Minute by Mr. J. Allan, *Ibid.*

3 Minute by Mr. Fullarton, *Ibid.*

Public Debt services.[1] The projectors of the Bank of Asia based their arguments on the practical working of the various colonial banks that had received their charters from the Imperial Government; they asserted that the proposed Bank would tend to strengthen the connexion between Great Britain and India, reduce the rate of interest of money in India, regulate the rate of exchange, supersede the necessity for the transfer of bullion and afford a permanent supply of capital; and most of all, it was claimed, it would separate the functions of banker and trader, thereby directing the energies, skill and means of the merchant more efficiently to purely mercantile pursuits and to the lucrative development of the resources of the country with which they traded, and leaving to the banker the important duty of an intermediate agent between the buyer and the seller of commodities.[2] They submitted, for the approval of the Government, only an outline of the proposed Bank: the capital was to be £ 2,000,000 with reserved powers of augmentation; three-fourths of the capital was to be subscribed and one-fourth to be paid up previous to the commencement of business; the Bank was to be a Bank of issue as well as of deposit, its operations were to consist of dealings in bullion, money and bills of exchange, lending money on commercial paper or

1 Baster, *op. cit.*, p. 99. Note the general objects of the Bank: "Convinced that one of the most efficient means for advancing the social improvement and extending the commercial enterprise of our valuable territories in India is to be found in the employment of English capital......we propose forming arrangements for the establishment of a bank in London, for transacting the monetary operations between Great Britain and her possessions in the East Indies, on principles similar to those banks which have been so successfully established for the West Indian, Australasian and North American colonies and which have received Charters of Incorporation from Her Majesty's Government." (House of Commons Papers, Vol. XXXV, 1843, p. 2).

2 House of Commons Papers, *Ibid.*

on Government securities and "in such other lawful ways and means as are usually practised among bankers"; and as regards the general control of the Bank, there was to be a Board of Directors in London holding £ 2,000 stock each, but the distant operations were to be carried on by local Boards or Managers within the Presidencies of India.[1]

The project raised most of the issues that had become prominent on the General Bank question. Was a bank for remittance transactions a useful institution to the public of India and could such a concern be combined advantageously with ordinary banking practices (i. e. discounts, loans and deposits)? And assuming that the answer was in the affirmative, was a special Charter necessary for the purpose? Finally, were the existing banks incompetent to handle those affairs which the proposed Bank of Asia wanted to take upon itself?[2]

The general comment was no different now from what it had been five years back. *Pure* remittance business might be a profitable enterprise, but there was every chance of its leading to stock speculation: it was impossible to regulate by Charter what securities were trustworthy or the prices at which they might be taken. A combination of such risky transactions with banking proper was all the more dangerous, and Mr. Prinsep cited occasions when during the difficult periods of capital lying idle in the Bank of Bengal he had resolutely opposed a resort to exchange business on the ground that such a procedure would threaten the entire

1 *Ibid.*

2 Cf. T. H. Prinsep, Bengal Financial Letters and Despatches, Vol. 81, 1841. (Mss.).

safety and stability of its resources.[1] As to the grant of a Charter, the Court of Directors pointed out that the business of banking in India could be carried on without the privileges of a Charter, while the general question of the utility of a new Bank brought forward the retort that with the recent extension of the capital of the Bank of Bengal and the establishment of the Bank of Bombay (1840) there was no need for a new Bank with a vast capital.[2]

Permission was, however, eventually granted by the Court of Directors, authorising the Government of India to grant a Charter under certain definite conditions.[3] But the grant of a Charter was withheld until the views of the Government of India were known, and these, though not unanimous, were definitely hostile. So the Charter was finally refused, although the Bank of Asia had agreed that it would not contemplate any new issues of notes.[4] Thus the grand project fell through, owing to circumstances similar to those responsible for the failure of the General Bank.

Was it ultimately to the good of Indian business and industry that these two grand schemes came to nothing? The point is debatable, but certain broad issues are clear.

1 *Ibid.*

2 House of Commons Papers, Vol. XXXV, 1843, p. 3.

3 The most important of these were: (1) Half the stated capital was to be paid up on opening and the remainder within twelve months afterwards. (2) Business was to be confined to receiving of deposits, discount of bills and general operations of a bank, excluding that of issue. (3) Its transactions were to be restricted to the countries and colonies lying within the recognised limits of the Company's Charter, and that they did not consequently embrace traffic in bills of exchange between these colonies and the United Kingdom. (4) Sufficient means were to be provided for giving due publicity to the state of its affairs.

4 *Ibid*, p. 7. To do justice to the Government of India it must be said that much of the suspicion was due to the vagueness of the project itself and the absence of useful details in the memorandum submitted by the promoters of the Bank,

Undoubtedly both the projects teemed with defects and were not based solely on an unselfish desire to promote industrial and business finance in India. The fall of money rates in England and the example of big profits made by chartered Colonial banks in other parts of the British Empire were certainly the prime incentives of these two grand projects.[1] On the other hand, it was not mere jealousy and selfishness that evoked the severe comments of Government experts and economists; the economic development of the country was still in a rudimentary stage and hence there were very few opportunities for the employment of capital in really profitable and sound enterprises. The few data we have got in the various Government letters and despatches lead to quite the contrary conclusion, viz., that even if more banks were established about this time there would have been very few openings for reasonably secure and profitable commercial and industrial investments.

This does not mean that the policy of the Government with regard to the economic development of India was perfectly sound and satisfactory. The economic equilibrium that had been rudely shaken needed careful handling; the old industries of India had decayed and there was no systematic effort on the part of the Government or of private entrepreneurs either to revive them or to replace them by new ones.[1] There was not any absence of credit, for as Mr. C. N. Cooke pointed out, there could be no surer proof of the soundness of a people's moral condition and of their habitual regard for truth than the prevalence of so much credit as was necessary to the existence of indigenous

1 Baster, *Ibid.*
2 Cooke: *op. cit.*, p. 15.

banking.[1] But unfortunately indigenous banking had decayed and was unable to cope with new needs and new economic factors. On the other hand, no amount of ambitious planning of banking finance could cure the industrial ills of India so long as the fundamental problems of labour, enterprise and management remained untouched. It was idle to talk of opportunities missed when there were few such opportunities for investment; in the absence of industries and manufactures the problem of industrial finance could hardly be said to have presented itself.

[1] Cooke: *op. cit.*, p. 15. Mr. Cooke says: "The native bankers themselves are patterns of commercial morality. The dishonouring of a *hoondee* is an event of rare occurrence with them."

CHAPTER V

Banking and Industrial Finance during the First Half of the Nineteenth Century (1806-60): An Evaluation

It would be a mistake to suppose that the projects of 1836 and 1840 were, apart from the Bank of Bengal affairs, the only efforts that had been made during the first half of the nineteenth century for the better organisation and development of banking in India. The abrogation of the East India Company's trading powers in 1833, following as it did the debacle of the Agency Houses during the crisis of 1830-32, gave a very great impetus to the establishment of joint-stock associations under the name of "Mofussil Banks."[1] The first and most important of these was the Union Bank of Calcutta, established in 1829, a few years before the actual abrogation of the Company's trading rights. The business of this institution included the issuing of promissory notes payable to bearer on demand at its office in Calcutta, discounting bills and promissory notes not having a longer period to run than four months from the time of discounting the same and lending money on the security of personal property for any period not exceeding four months or on cash accounts to persons of undoubted security. The Bank was expressly forbidden to issue notes or discount bills in any other manner than above and was asked not to purchase lands, houses or any other real property, nor any goods or merchan-

[1] C. N. Cooke, *op. cit.*, pp. 18-19.

dise for the purpose of making a re-sale and profit.[1] In spite of all these restrictions, however, the Bank made considerable profits during the first decade of its inception—a fact clearly proved by the dividends it paid.[2]

1832	...	6%	1837	...	14%
1835	...	10 ,,	1838	...	12 ,,
1836	...	10 ,,	1839 (Jan.)		11 ,,

The year 1839, however, was the last high-water mark in the prosperity of this Bank. Although the capital was increased to Rs. 100,00,000 (1 million £ sterling) in June of the same year, the dividend never reached more than 8% (with the solitary exception of 1841 and 1842 when it was 9 and 10 per cent respectively) until it stopped payment in 1848.[3] The sudden increase of capital was, in the absence of suitable ways of getting in touch with, and financing, indigenous enterprises, responsible for some indiscreet investment: large advances were made to the indigo houses of Calcutta on the deposit of title-deeds of their factories and assignments of the annual produce, and resort was also made to the Scotch system of lending money on cash credits granted on the personal security of the borrower and repayable not at a fixed time, but as his returns became available. The crisis came in 1842-43 when many of the indigo houses failed: about 60 lakhs of rupees were locked up in indigo concerns, and nothing but indigo-factories were the securities for this huge debt. The Bank decided not to sacrifice the indigo

[1] Copy of the Deed of Co-partnership of the Union Bank, Bengal Financial Letters and Despatches, Vol. 29, 1831 (Mss.).

[2] Cooke, *op. cit.*, p. 179.

[3] Cooke, *op. cit.*, pp. 179-80.

factories but to carry them on, limiting the advances as much as possible and gradually disposing of the factories themselves. They argued (and perhaps with some justification) that if they stopped the advances, the debt and the properties themselves would be destroyed; on the other hand, they counted on the fair prices that might be fetched by an article like indigo of which Bengal had a virtual monopoly.[1] Actually, however, the policy of the Directors was governed less by this consideration than by a more selfish interest: they were heavily and hopelessly indebted to the Bank and the keeping up of the mortgaged factories enabled them to ward off, to an indeterminate period, the fatal day of insolvency.[2] It was this "shameful violation of their trust" by the Directors that precipitated the crisis. The failure of the Union Bank in 1848 pointed to the danger of large capital investments in an unstable economic equilibrium: it was the absence of suitable avenues of employment that had resulted in the forced idleness of vast sums of money and had, therefore, led to unwise and speculative dealings.

The Union Bank was not the only important effort to supplement the banking needs of India. Although the Agency Houses were but a shadow of their former selves after the crisis of the thirties, a very strong attempt was made about 1833 to "remodel and increase them to such an extent as the duty to be performed by them urgently demanded."[3] Some members of the late firm of Messrs. Alexander & Co. solicited the Government to afford pecuniary aid for a short time to the trustees to

1 Evidence before the Select Committee on East India Affairs, 1840.
2 Cooke, *op. cit.*, p. 199.
3 Bengal Financial Letters and Despatches, Vol. 36, 1833 (Mss.).

be appointed by their creditors, while others appealed to the fact that public interests were deeply involved in the affairs of these houses. But the Government rightly refused to prop up an antiquated machinery of banking and finance, and so in the end the effort came to nothing.[1]

Another bank of this period was the Agra and United Services Bank established in 1833 with a capital of Rs. 5,00,000 at commencement with Agra as its centre of activity. Its object was to restrict its operations to purely monetary transactions such as discounting of bills and bonds, traffic of bullion and foreign coin and granting of loans upon securities, and it solemnly affirmed not to meddle in actual commerce or trade.[2] After its establishment the Directors of the Bank sought to make the Government a shareholder in its concern, but the Government of India was rather sceptical about its success and declined to interfere. In a typical minute the Governor-General said: "I am of opinion that for very many years to come, until the European and native society assume a very different character, there can be no real credit and confidence like that which exists in other countries. Respecting the Europeans, that which constitutes the best security elsewhere has been hitherto made impossible by the restriction against holding lands; and the immediate removal of all wealth and property as soon as it is made and the substitution of a pauper partner in the place of the enriched predecessor who leaves nothing behind him but his name, take away all the other foundations of permanent credit and confidence. The native part

1 *Ibid.*

2 *Ibid*, Vol. 40, 1834. (Mss.).

of the community have both lands and money, but still they have to attain a higher standard of moral character as a body before they can expect to secure from their own countrymen or strangers that credit for punctuality and correctness of dealing which shall lead to complete confidence."[1] The rejection of the Bank's overtures by the Government, however, did not lead to any slackening of the Bank's enterprises: on the other hand, it reiterated its determination not to engage in any way, either directly or indirectly, in commerce or trade.[2]

Among other mofussil banks of this period mention may be made of the North-Western Bank of India, the Delhi Bank, the Simla and Umballa Bank, the Benares Bank and the Dacca Bank. Banks of the Exchange group like the Oriental Banking Corporation, the Chartered Bank of India, London and China and the Commercial Bank of India ought to be treated separately although there was no hard-and-fast line of demarcation between these latter and the former group. The mofussil banks were mostly in a rudimentary stage of development, government securities and ordinary loans to individuals (of whom often a large majority consisted of civil and military servants of the Company) occupying most of their attention, and actual discounting of mercantile or commercial bills and advances to entrepreneurs being negligible in amount. This was not the fault of the banking institutions as such: there was very little active demad for industrial or business

[1] Minute of the Governor-General (dated the 21st December, 1833), *Ibid.* Note that the Governor-General's picture of Indian business morality is almost diametrically opposite to that of such observers as Cooke and Prinsep.

[2] *Ibid.*

accommodation and so the funds of the banks had to be employed in private loans or Government securities. In 1845-46 the Agra and United services Bank, for example, could show no more than 10.9% of its loans and credits going to parties engaged in trade, industry and commerce and less than 5% employed in discounting.[1] Again, the Delhi Bank (established in 1844) had on the 1st July, 1846, a total capital of Rs. 16 lakhs and a total deposit of abou 4 lakhs ; out of this, loans to individuals accounted for only a small fraction while exchange operations, investments in Company's paper and cash in hand represented about 12 lakhs of rupees.[2] Loans were not indeed confined to members of the Services as was generally supposed, but rigid rules had to be laid down as regards the security and the character of the parties with reference chiefly to the means of payment. These were very necessary, for, without such safeguards, there was every likelihood of ordinary banking operations being mixed up with speculative ventures.

On the other hand, there were certain obvious defects in the law of mortgages etc. which prevented some of the banks from playing their useful part in the community. The North-Western Bank of India, Meerut, for instance, was more "a Savings Bank of the Services" and its services to the agricultural portion of the community were negatived by the law of Registration of Mortgages[3] and by the policy of scrutinising enquiries

[1] The Report of the Bank submitted to the Government in response to an enquiry on "Private Banks" operating in India in 1848. *Vide* B. F. L. & D., Vol. 95, 1848 (Mss.).

[2] Report from the Delhi Bank, *Ibid*, Vol. 95, 1848 (Mss.).

[3] The registration of mortgages of land was not compulsory at a fixed Registry Office in the district of the estate and a registered mortgage did not take precedence at law over all other mortgages. So the banks were often unable to assist the agriculturists and smaller industrialists with advances owing to the difficulty and almost impossibility of ascertaining what previous claims might be held on the property offered. *Ibid.*

into the means of repayment.[1] The lack of a contact between the indigenous banking system and the superimposed European structure led to the strange result that most of the advantages went to the European section of the community, so that there was much truth in what the Governor-General (Lord Hardinge) said in 1848: "Banking is a misnomer for the operations of the very many institutions as yet established which are rather of the nature of joint-stock loan societies than banks and exercise little or no perceptible effect on the general trade and prospects of the country."[2]

On a slightly different pole stood the so-called Exchange Banks of which the Oriental Banking Corporation[3] (established in 1842) was the first and most important. It was intended to supply the need for a bank with powers to conduct exchange and other legitimate banking business from which the Banks of Bengal and Bombay were expressly excluded by their Charters. The Oriental Bank made great progress and in 1845 its head office was moved from Bombay to London: its great success was undoubtedly due to the failure of the Agency Houses and the cessation by the East India Company of the practice of making advances in India against bills of lading to the extent of £ 2,000,000 a year.[4] The prosperity of the Oriental Banking Corporation led to the establishment of other Exchange Banks like the Chartered Bank of India, Australia and China, the

1 Each loan was generally secured by two or more sureties *plus* a life insurance in many cases. *Ibid.*

2 The Governor-General's Note on the Report on Private Banks, Bengal Financial Letters and Despatches, Vol. 95, 1848 (Mss.).

3 This originated from a co-partnership called the "Bank of Western India." See Baster, *op. cit.*, p. 104.

4 Baster, *op. cit.*, p. 107.

Commercial Bank of India and the Mercantile Bank of India—all established between 1845 and 1853. But none of these Banks directly participated in the industrial or business finance of the country and their main operations were concerned with exchange and movements of bullion. In that branch of banking they certainly filled up a gap.

As all these inroads were being made into the sphere hitherto monopolised, as it were, by the Bank of Bengal, the Government of India was viewing with alarm the growing exasperation of some business and mercantile interests at the absence of suitable borrowing and investing facilities in the two Presidency towns of Bombay and Madras. After much waste of ink and paper and a singularly procrastinating exchange of letters and despatches between the Home authorities and the Indian Government, Act No. III of 1840 was passed by the Governor-General-in-Council for the incorporation of a Bank at Bombay "on the same principles as were prescribed for and have been observed in the re-incorporation of the Bank of Bengal, by Act No. VI of 1839."[1] The establishment of the Bank of Madras followed three years after—again on the same principles and with the same limitations as those of the Bank of Bengal. The very establishment of these Banks, however, showed that the Government could not afford to remain quite impervious to mercantile clamour for more adequate means of accommodation.

Even a very superficial survey of the banking history of this period, however, points to the comparative paucity of *real* banking institutions satisfying the banking

[1] House of Commons (East India) Papers, 1860, Cmd, 53.

needs of India. Even as late as 1860 a Return to an Address of the House of Lords calling for a list of all banks[1] then existing showed how very small the number of institutions conducted on western lines was. Apart from the three Presidency Banks, Bengal could claim only seven and the countryside only five banks; and most of these were either Exchange banks pure and simple or mere apologies for banking institutions.[2]

The blame does not, however, lie with the banks as such. It was the industrial stagnation of India due to causes over which banks had no control that was primarily responsible for the imperfect and one-sided development of India's banking institutions. An anonymous writer of this period most pertinently asked: "How is it that, notwithstanding we are the rulers of the country and that it contains a vast population which, it is now clearly ascertained, have no disinclination, but on the contrary, a strong desire to possess articles of British product and manufacture, our exports to it should not, at an average, exceed 3½ millons a year, being less than half our exports to the U. S. A.?" And he replied: "The cause of this anomaly is apparent. It results entirely from the backward state of industry in India and from the difficulty the people

[1] House of Lords Papers, 1860, Cmd. 99. No definition of the word "bank" is given, but apparently only those institutions that were conducted on European lines were meant.

[2] *Ibid.* The official list is as follows:

Bengal: Bank of Bengal; Agra and United Services Bank with branches at Madras and Bombay; Chartered Bank of India, Australia and China with a branch at Bombay; Chartered Mercantile Bank of India, London and China with branches at Madras and Bombay; Commercial Bank of India with a branch at Bombay; North-Western Bank of India; Oriental Banking Corporation with branches at Madras and Bombay; Government Savings Bank.

Country Banks: Dacca Bank; Delhi Bank; Simla Bank; Uncovenanted Services Bank of Agra; Agra Savings Bank.

Madras: Bank of Madras; Government Savings Bank.

Bombay: Bank of Bombay; Government Savings Bank.

experience in raising products with which to pay for our goods. According as this difficulty is diminished, i.e., according as India succeeds in producing articles suitable for our markets, the commerce with her will be extended and may indeed attain to any conceivable limit. And it so happens that the very articles which form what are called the grand staples of India are those best suited for our markets and nothing but a deficiency of enterprise and skill prevents her from attaining to the highest rank as a mart for these articles."[1]

It was no wonder, therefore, that the proper channels of investment were so inadequate. Even the few banks that flourished had to invest a considerable amount of their loanable assets in Company's paper and Government securities. We have cited before the actual figures of the Bank of Bengal in this matter; the Bank of Bengal, however, did not stand by itself so far as this was concerned—corresponding figures of the Banks of Bombay and Madras, too, support such a view.[2]

1 Reasons for the Establishment of a New Bank in India, *Ibid.* P 25.

2 A statement of the monthly average of business transacted by the Bank of Bombay from June 1840 to June 1841 gives a fair idea of the situation: (B. F. L. & D. Vol. 84, 1841. Mss.).

Month 1840.		Paid-up Capital.	Borrowed capital (Deposits and Circulation.)	Employed in bank business (Loan, cash credit etc.)	Invested in Government paper.
June	...	Rs. 52,25,000	Rs. 21,57,000	Rs. 6,68,901	Rs. 26,25,580
July	...	„	25,06,000	5,37,560	26,08,090
August	...	„	33,21,400	4,76,286	29,09,120
September	...	„	37,63,740	3,26,460	51,26,560
October	...	„	34,65,770	3,22,290	51,88,260
November	...	„	32,91,270	4,59,010	52,06,460
December	...	„	33,56,430	9,46,640	52,06,460
1841.					
January	...	„	32,55,800	12,62,890	52,06,460
February	...	„	25,30,908	15,21,140	51,26,460
March	...	„	26,17,810	17,22,070	50,66,960
April	...	„	30,54,810	23,47,920	50,61,660
May	...	„	23,15,440	26,87,660	34,85,430
June	...	„	21,54,600	22,86,650	33,81,580

Considerable light on the state of the Indian money market about this period is also thrown by the reports published in the pages of "The Indian News"—a journal published monthly in London on the day after the arrival of the Overland Mail.[1] In spite of references to occasional stringencies and tightness of money (very often due to political factors such as the Sikh wars and Afghan campaigns) the general impression obtained from a perusal of the reports from Calcutta and Bombay is one of cheap and abundant money in the market. In general money was abundant in the bazaar for all purposes and sometimes considerable Government loans were opened (e.g. in 1840) with a view to taking up much of the floating capital in the market.[2] There were no doubt seasonal fluctuations in the market, but on the whole a superabundance of money for all purposes was the normal feature of the market.[3] Even after the commercial crisis of 1847-48 the money market soon returned to its habitually easy position and early in 1850 it was reported that "the money market was abundantly stocked and capital readily obtainable on easy terms whenever good and tangible securities were offered."[4] The embarrassing abundance of money continued during 1851-52 when loans were offered at 4 to 5%, as capitalists could not find full employment for their funds; this state of affairs continued to such an extent that in August 1852 a meeting was held among the proprietors of the Bank of Bombay for the purpose of taking into

[1] This was first published on the 11th June, 1840 and was subsequently amalgammated with "Allen's Indian Mail" in 1858. The last issue of "The Indian News" is dated the 27th July, 1858.

[2] The Indian News (London), 10th December, 1840.

[3] *Ibid*, all the issues commencing from 7th May, 1844, to 24th March, 1847.

[4] *Ibid*, 2nd April, 1850.

consideration a proposal for an application to Government for a modification of the 1840 Charter which precluded them from dealing in foreign exchange business.[1] Even the violent disturbances of the Indian Mutiny in 1857 caused but a ripple on the quiet abundance of money in India, and as soon as the Mutiny was well under control, the temporary tightness of money was eased and funds became as plentiful as ever.[2]

All this shows how very dangerous it is to attribute the industrial stagnation of India up to about 1860[3] to the lack of credit facilities or to an alleged policy of banks deliberately to withhold credit from business or manufacturing interests. The insistence on caution and security by the banks was inevitable on account of the unstable economic factors in the India of this period; moreover, the unfortunate antecedent history of the Agency Houses and of the Union Bank of Calcutta clearly demonstrated the imprudence of rash and speculative investments. There is no record of any legitimate industrial or manufacturing enterprise, otherwise sound and solvent, having been handicapped either at its inception or during its subsequent development by the lack of credit facilities. It is, therefore, the height of folly to imagine that the industrial development of India during this period might have been improved, in the absence of other co-ordinating factors, by a mere piling up of more capital and more banking institutions.

[1] *Ibid*, 29th June and 5th October, 1852.

[2] *Ibid*, 27th July, 1858.

[3] This date is rather arbitrarily chosen: in 1860 the limited liability principle of joint-stock associations was extended to banking institutions as well.

This does not mean that the banking system, as it stood, was perfect. Undoubtedly there were weaknesses and defects and the absence of a link between the decaying indigenous banking houses and the new banks conducted on European lines was perhaps the most significant weakness in the sphere of banking finance. But apart from this, the problem of industrial finance had not as yet presented itself on any important scale in India. There was no comprehensive policy for industrial development and even with regard to the cultivation of such products as cotton, flax-fibre, hemp etc. which might serve as the raw-materials for English manufactures, only the most imperfect beginnings had been made.[1] Of the plantation industries, a number of tea gardens had been started with European capital about the middle of the century, but it was only after the crisis of 1866 that they entered on a period of harmonious development.[2] Some efforts were being made with the cultivation and manufacture of coffee but the question of finance had not yet assumed the magnitude of a problem. With regard to cinchona, only preliminary experiments and researches were being made, the question of large-scale cultivation and manufacture belonging to the latter half of the century.[3] It is no wonder, therefore, that the Government of India as well as the Home authorities were generally suspicious of so-called investment demands of the business and mercantile classes, for such demands were often speculative and hardly distinguishable from

1 Edinburgh Review (July, 1855). Dr. J. Forbes Royle's researches on cotton, Dr. Jameson's on flax-fibre, Dr. Buchanan's on common mallow, Dr. Roxburgh's on the Sunn plant and Dr. M'Gowan's on the Rhea fibre had yet to be co-ordinated and built up into an economic policy.

2 V. Anstey: The Economic Development of India (London, 1929), p. 286.

3 Edinburgh Review (April, 1862).

stock-jobbing.[1] Even as early as 1843 far-seeing bankers and financiers had pointed to the dangerous tendency of some banks to advance money to indigo-planters on the security of their "block", which term included "the whole fixtures, appurtenances and even the growing crop of an indigo factory"! In their search for a quicker road to a large dividend many of these banks would make advances in an extremely loose manner, e.g. even on silk filatures and on stocks of tradesmen; but their limited knowledge of market conditions and the absence of the power of superintendence always made such transactions dangerous, abortive and unprofitable. However carefully guarded, transactions of this kind were of a nature contrary to proper banking business, and nobody was surprised when, after a temporary frenzy of excitement, most of these investments proved to be bad and unprofitable.[2]

As a matter of fact the first sixty years of the nineteenth century was a period of the slow decline of the indigenous industries: the subsequent rise of one or two large-scale industries belongs, more correctly, to the latter half of the century. "In India there was a much more definite hiatus than in the West between the decay of the handicrafts and the establishment of factories, during which certain types of demand were largely met by imports."[3] It was no wonder, therefore, that capital investments in industrial and business concerns were so meagre compared to the vast size and potential

1 Bengal Financial Letters and Despatches, Vol 95, 1818 (Mss.).

2 The Economist (London), Oct. 21, 1843. "One of the most serious consequences of banks going out of their way to afford facilities of this kind was the direct tendency which these facilities had to make the trade even more hazardous than it otherwise would have been. These facilities induced men to open and extend concerns which would never have been done."

3 Anstey: *op. cit.*, p. 207.

resources of the country. On the one hand, the small amount of Indian capital that was available for investment found an easier and more profitable outlet in commerce than in industry; the Indian mercantile classes eagerly embarked in all kinds of speculation in which they had an immense advantage in skill, knowledge of the country, local connexion and cheapness of agency, over the European capitalists.[1] On the other hand, European capital investments were not also very large: apart from investments in railways and banking institutions, they were hardly more than £ 10,000,000 towards the close of our epoch.[2] The great difficulty of pioneer work and the unusual novelty of undertakings in a distant country like India naturally served as deterrents to the free flow of capital to India—a fact illustrated by the early history of railway construction and finance in India.[3] The comparative paucity of invested British capital in India was *not* due to the difficulties of European colonisation in India as was generally supposed. It was due to the fact that Englishmen arriving

[1] The Economist (London), April 10, 1852: Extract from George Campbell's "Modern India" (London).

[2] R. M. Martin in his "The Progress and Present State of India" (London, 1862) gives an account of the approximate investments by British capitalists in Indian associations:

Railroads	£	50,000,000
Ocean and River Steam Navigation and Irrigation and Canal companies ...	„	6,000,000
Banks	„	10,000,000
Tea and Coffee Associations ...	„	1,000,000
Coal and Mining Association	„	500,000
Cotton companies	„	1,000,000
Gas and sundry other co-partnerships ...	„	1,000,000 (p. 290).

[3] The Economist (London), August 4, 1849. Inspite of the absolute and complete guarantee of the Indian Government, the uneasiness of shareholders and debenture holders in the Railway companies as to the sufficiency and perfection of the guarantee manifested themselves more than once during the sixties of the century. See the correspondence in the Economist, Nov. 23 and 30, 1861.

in India were attracted by what they heard of the great and rapid profits to be made from certain businesses (like indigo) and, therefore, abandoned the idea of entering upon other undertakings which offered less advantages and took more time to be brought to a successful issue. On the other hand, the loud complaints made by indigo-planters and allied entrepreneurs of the obstacles they professed to meet with from the nature of the administration in India had the effect of creating a vague but general fear of *all* investments in India, whether connected with the land or otherwise. Further, Englishmen looked upon India as a place of temporary sojourn to be quitted as soon as possible, and hence did not wait long enough for the proper devolopment of their undertakings: they left everything in the hands of careless and corrupt agents, and failure was, of course, the result. Unless and until these problems were tackled, not in a half-hearted mood, but with a far-seeing and comprehensive vision, the question of difficulties as to the actual finance of industrial undertakings could not arise at all.[1]

Were the restrictions imposed on the three Presidency Banks by the terms of their Charters unusually severe? The Government rightly contended that being more or less public institutions with enormous Government interests involved and being more in the nature of central banking institutions, these Banks had to make a very careful scrutiny of their business transactions. With this end in view, the Charters had been made exceedingly severe as regards both the extent of each loan and its duration, while the nature of the security

[1] See the brilliant article on "Why is not British capital more largely invested in India?" (The Economist, October 9, 1858.).

demanded prevented any possible speculative risks.[1] Towards the middle of the nineteenth century, however, the construction and development of railways began to attract the attention of British capitalists and entrepreneurs, and the East India Company found that unless the clauses of the Charters for the Banks of Bengal, Bombay and Madras were modified, initial British investments would be greatly handicapped by a lack of capital while work was in progress and railway development would be retarded in consequence. So, in response to the clamour of British investors and promoters, and also with view to smoothing out railway development in India Act XXI of 1854 was passed empowering the Banks "to lend money on the security of the shares in such of the incorporated Railway Companies as hold a guarantee from the East India Company"; and with regard to interest it was provided that no such loan was in any case to exceed in amount three-fourths of the paid-up value of the shares on the security of which the loan was made and in every case such shares had to be transferred to the Bank by

[1] Thus Act No. VI of 1839 revising the Charter of the Bank of Bengal said :

"Art. XXVII. And it is hereby enacted, that the directors of the said Bank of Bengal shall not discount any negotiable securities which shall have a longer period to run than three months, or lend money for a longer period than three months, and that they shall make no loan or advance on any bank share or certificate of shares, nor on mortgage, or in any other manner on the security of any lands, houses or immoveable property, nor on any negotiable security of any individual or partnership firm which shall not carry on it the several responsibilities of at least two persons or firms unconnected with each other in general partnership, nor give advance at one and the same time to any individual or partnership firm either by way of discount, loan, or in any other manner (saving by loan upon the deposit of Government securities, or goods not perishable as hereinafter mentioned) beyond the amount of three lakhs of Company's rupees ; provided always that advances upon bills of exchange accepted by the Government, or upon any other Government obligation shall not be considered as an advance within the meaning of this restriction.

"Art. XXVIII. And it is hereby enacted that the directors of the said Bank shall make no loan other than such loans as are described in the section next preceeding, except on deposit of public securities to the full amount of the loan, and which public securities shall be so endorsed or transferred as to put them at the absolute disposal of the said Bank of Bengal, or on deposit of goods, not of a perishable nature, and of estimated value exceeding the amount of the loan by at least one-fourth."

which the loan was made, either absolutely or by way of mortgage.[1] This concession was not so complete as it seemed at first sight: but it was a move in the right direction. This was followed by Act XXVII of 1855 which empowered the three Presidency Banks to transact business of a new kind, viz., to take charge of Government securities or shares, to receive interests or dividends on any such securities or shares, to invest any money deposited in the purchase of any such securities or shares, to sell or transfer any such securities and to re-invest the principal, interest or dividend so received in Government securities or shares.[2] Although this Act did not give any positive help to the cause of industrial development, it certainly gave the Banks some more freedom and latitude than they had hitherto enjoyed.

While these Acts sought to enlarge the scope of the business allowed to the three Presidency Banks, the authorities were not impervious to the most patent defect in the banking organisation of India. Apart from the three Presidency Banks which had got special Charters of their own, and some Exchange Banks which also had got the legal privileges of limited liability through the grant of special Charters, most of the so-called mofussil banks were without the legal protection of the principle of limited liability.[3] This loop-hole in the banking law of India adversely affected the progress and

1 W. Theobald: Legislative Acts of the Governor-General of India, 1849-55. (Calcutta, 1860), p. 634.

2 *Ibid*, p. 803.

3 Some of the earliest European joint-stock banks in Calcutta enjoyed the privileges of limited liability before it was permitted in England, but most of these institutions had disappeared during the crisis of 1829-30, and, further, the privileges had not been conferred by any general Act, but had been granted only in individual cases. See H. Sinha: *op. cit.*

development of banking and business finance in two ways. Firstly, the very absence of the privilege precluded the establishment of special banking institutions catering for the varying and peculiar needs of India's industries and agriculture. Secondly, in the absence of this privilege, the existing banks were forced, by the logic of facts, to act with an extra amount of caution and hesitation when making advances or investments. Act No. XIX of 1857 conferred the privilege of limited liability on joint-stock associations in general, but the first section of the Act expressly excluded associations for the purpose of banking or insurance from this privilege. It was only three years later that this restrictive section was repealed[1] and in 1866 the famous Indian Company's Act[2] consolidated the accepted principle that "no member of joint-stock association shall be liable for more than the unpaid portion of his share and that in case of guaranteed companies no member was to be liable beyond the amount of his guarantee."

These Acts were not, by themselves, enough to accelerate the industrial developmnet of India; much more was yet to be done in spheres other than those of pure banking and finance before the beneficent provisions of these new measures could make their influence felt. But the Acts certainly opened a new chapter in the field of banking and industrial finance in India for they cleared the way for varied banking activities and for the establishment of suitable institutions for the mobilisation of enterprise and capital.

[1] By Act VII of 1860. See Theobald: *op. cit.*

[2] Act X of 1866, *Ibid.*

CHAPTER VI

THE EARLY YEARS OF INDUSTRIAL DEVELOPMENT AND THE INFLUX OF FOREIGN CAPITAL (1866—1905)

The Indian Companies' Act of 1866 consolidating the already accepted principle of the limited liability of a member of a joint-stock association was an important step in the direction of industrial devlopment in India, as it paved the way for the investment of capital in such companies. But this Act was not the only factor that cleared the way for varied industrial activities. The very end of the "great events, fierce passions, and tremendous problems of the Mutiny" led to a period of material, moral and intellectual progress, of improvements in communication and of commercial and industrial development.[1] Money began to flow to India from England in a steady stream and the whole of the second half of the nineteenth century was characterised by the investment of British capital and the employment of British private enterprise in the mines, factories and manufacturing concerns of India. During all these years Indian capital played a very unimportant part in the industrial development of the country, and, except for the solitary instance of the cotton textile industry of the Bombay Presidency, almost all the concerns were financed by British money and managed by British brains.

It would be appropriate to consider here what state of affairs prevailed in the capital and money-market

[1] P. E. Roberts : History of British India (Oxford, 1930), p. 387.

of India before she passed under the direct control of the Crown. The first point to be noticed is that there was no organised money-market at all: the three Presidency Banks were independent of one another and even simultaneously published official rates of discount of the three Banks often showed wide divergences. Moreover, these official rates were hardly conformed to outside the walls of the Presidency towns. On the other hand, there were a number of joint-stock banks (established by European companies) which found it difficult to employ their relatively large funds in sound but profitable enterprises. In their search for a quicker road to a large dividend they often felt a strong disposition to go out of strict banking business and make advances on such securities as silk filatures, stocks of tradesmen etc. In no case did such business prove ultimately profitable: we have seen how advances of this type had proved a source of frequent loss even to the old commercial Agency Houses whose whole business had been to watch them and whose more accurate knowledge of every circumstance connected with the market might have made such investments less dangerous for them.[2] It was no wonder, therefore, that when the ordinary commercial banks went out of their way to afford facilities of this kind, they not only brought ruin upon themselves, but made trade and industrial enterprise even more hazardous that it otherwise would have been: these facilities induced men to open and extend concerns of doubtful stability which, but for those facilities, would never have been opened.[3]

[1] The Economist (London), August 4, 1849.

[2] See *supra*, Chapter III.

[3] The Economist (London), October 21, 1834.

The fundamental fact was the industrial stagnation and disequilibrium of the country, and this was due to a multitude of factors little connected with the difficulty of obtaining the requisite capital and finance. While the internal capital market was notoriously shy, the investment of British capital in India during the days of the East India Company was also very small. Even with regard to railways, so long as the East India Company was in power nothing much was done until Lord Dalhousie came.[1] Dalhousie conceived a new idea : he saw that state intervention must not paralyse private enterprise, and his idea was translated into practice by the institution of the ingenious "guarantee system". Moreover, the reduction of returns from Continental enterprises owing to a keener competition there and the uncertainty of American investments owing to the Civil War (which broke out in 1861) focussed the attention of the London money-market upon the economic development of India.[2]

At first, this enthusiasm was confined to investment in railways alone.[3] Even here a guarantee was needed : the novelty of the undertaking owing to the peculiar circumstances of the country was not calculated to inspire confidence in the minds of British investors. On the one hand, it was necessary that the guarantee

1 L. H. Jenks: The Migration of British Capital to 1875 (New York, 1927), p. 207. "Guarantees did not build railways—much less encourage capital to rush recklessly into projects which did not bear them. Enthusiasm as expressed in stuffy banquets and weighty memorials was great, but the faith that moves money market was lacking."

2 *Ibid*, pp. 218-19.

3 The outflow of capital upon railways in India was as follows during 1858-69 :

1858	£ 5,500,000	1862	£ 5,800,000	1866	£ 7,700,000
1859	£ 7,150,000	1863	£ 4,780,000	1867	£ 7,000,000
1860	£ 7,580,000	1864	£ 3,800,000	1868	£ 4,500,000
1861	£ 6,500,000	1865	£ 5,400,000	1869	£ 4,400,000

should be complete; on the other, it was equally necessary that private enterprise should not be deprived of those great inducements which a deep interest in an undertaking alone could secure. These two necessary but conflicting objects it was difficult to reconcile, but an honest attempt was made by the device of what later came to be known as "the old guarantee system."[1]

British capital began to pour into India under the stimulus of this guarantee. The terms of the guarantee have been severely criticised by some economists and financiers, but it is difficult to see in what other way the requisite capital for the development of Indian railways could have been raised. So deep-rooted were the suspicions of the investing public about the profitable nature of these enterprises that even in 1861 (when railway construction had made considerable progress) the Railway companies found it difficult to raise some extra capital even with the guarantee of the Indian Govenment and the Government had to borrow the capital *direct* on behalf of the Railway Companies.[2]

The expansion of railways in India was a great help to the devolopment of new industries and the reorganisation of old ones. But, for a considerable time to come, British investments were confined to certain old orthodox types of ventures. The real causes for the meagre investments of British capital in undertakings other than railways and indigo were, however, twofold. First, other undertakings required considerable time and capital for

1 For details of the terms of this system, see Jenks: *op. cit.*, p 219.

2 *The Economist* (London) May 25, 1861. Articles in *The Economist* (November 23 and 30, 1891) explaining the exact nature of the terms of the "guarantee" and assuring the holders of railway shares and debentures about its sufficiency and perfection show how great were the suspicion and uneasiness of British investors.

their successful development; but Englishmen arriving in India or British investors staying in Great Britain were more readily attracted by what they heard of the great and rapid profits to be made from indigo etc., and so abandoned the idea of entering upon other undertakings which offered less advantages and which must have taken more time to be brought to a successful issue. Secondly, the loud complaints made by the indigo-planters of the obstacles they professed to meet with from the nature of the administration in India had the effect of creating a vague but general fear of *all* investments in this country, whether relating to the land or otherwise.[1]

As the years, however, rolled on to the end of the nineteenth century, the influx of foreign capital into India began to assume increasing proportions. Various factors contributed towards this change: internal wars and rebellions gradually became things of the past, while such troubles as the Russian and Afghan menace on the north-western, and the French and Burmese menace on the north-eastern frontiers were too infrequent and distant to affect the confidence of the British investing public. On the other hand, experts, both official and non-official, were engaging themselves in exploring the possibilities of enterprises like gold, copper and iron-mining, the manufacture of jute, the making of yarn and cotton piece-goods from India's own raw-materials and labour, and so forth. These researches and explorations naturally led to a corresponding eagerness on the part of investors to employ their money in new enterprises, and they realised that the country, in spite of its apparently primitive wants, offered a large scope for British money.[2]

[1] *Ibid.*

[2] The Economist (London), April 2, 1881.

Under the peculiar circumstances of the economic development of India about this period, there arose an ingenious system of finance and management called the "Managing Agency" system.[1] There were old well-established trading firms (mostly British) at the important Indian ports and these were mostly concerned with the external (and sometimes also internal) trade of the country.[2] Now, the new joint-stock companies began to look to the public for money for the promotion of specific enterprises, but at the same time they preferred the risk to fall on others; on the other hand, British promoters (especially of small and new ventures) were only too glad to have the backing of the name of one of these big, well-established firms and were only too eager to link the larger organisation with their own.[3] Moreover, the fact that most of the promoters of new ventures remained in India only for a short period and had a very imperfect knowledge of the peculiarities of Indian business and industrial enterprise made it almost imperative that the actual management of the new projects was to be handed over to old firms of established reputation and experience. The actual promoters of a company would raise the necessary initial capital while the Managing Agents would, by their Articles of Association, undertake to manage the venture on behalf of the company in return for an annual sum for office expenses and a commission on output, sale or net profits.[4] These firms facilitated continuity of policy, conduced to efficient and economic manage-

1 For a detailed examination of the history and subsequent development of this system, see *infra*, Chapter IX.

2 V. Anstey: The Economic Development of India (London, 1931), p. 113.

3 The Round Table (London), March, 1923.

4 Anstey: *op. cit.*, pp. 113-114.

ment, and very often helped a concern with their own funds in times of temporary stringency or difficulty. On the whole, they worked very well during the second half of the nineteenth century: the system had a far greater list of successes to its credit than could be shown by ordinary company management under individual managing directors.[1]

The European Managing Agency firms did not, however, play an important part in the actual finance of industrial undertakings, although they often helped their managed enterprises with funds if the latter were in temporary difficulties. The Indian Agency firms of Bombay and Ahmedabad, however, although products of similar economic circumstances, played a much more important part in the financing of the textile industry with which they were mostly connected. It was their enterprise and money that brought the industry into being at a time when grave doubts were entertained as to whether cotton spinning and manufacturing could be carried on in India in competition with industrially advanced countries of the west and when capital was notoriously shy.[2] These firms of Bombay and Ahmedabad performed the double function of satisfactorily working the mills and also of financing them. While actual figures or details as to the extent to which a Managing Agency firm "financed" a particular mill are not available, it seems that much of the working capital came from the Managing Agents while a considerable proportion of the block capital was derived either from private deposits or from public purchase of shares.[3]

1 Report of the Indian Industrial Commission (1916-18), p. 13.

2 Evidence of the Bombay Millowners' Association before the Cotton Textile Industry Enquiry of 1927 (Report of the Indian Tariff Board—Vol. II).

3 *Ibid.* The Association could not say with any amount of definiteness or precision what percentage of the block or working capital generally came from a particular source.

On the whole, so far as certain particular industries[1] are concerned the second half of the nineteenth century witnessed a steady, but by no means astonishing, investment of British capital in India. In 1854 coal was being mined in the Raniganj field; the next year jute was spun by machinery for the first time; the cultivation and manufacture of tea steadily extended after the sixties of the century; in 1875 the Bengal Iron and Steel Company started its operations, and, last but not least, several gold-mining companies started work in Mysore and adjacent districts during the last three decades of the century.[2] So far as the raising of initial capital was concerned, no acute "problem" may be said to have existed. There was, of course, the natural hesitation on the part of British investors to sink money in ventures which did not offer the most assured return, and this hesitation was sometimes due to the vicissitudes of fortune that often overtook some particularly rash and speculative ventures. But, on the whole, the difficulty at bottom was not one of finance, but one of efficient management, of sound co-ordination of the various factors of production and of securing an intelligent and efficient labour-force.[3]

It is indisputable, however, that most of the industrial investments of this period were confined to certain stereo-typed lines. As the figures for the various joint-stock companies would show, tea and other planting companies, cotton and jute textiles and certain forms of mining were the only ventures in which a considerable proportion of capital was invested. This was perhaps due, to a certain extent, to the fact that the guarantee

[1] E.g. Tea and other plantation industries, mining companies, cotton mills and jute mills.

[2] See Appendix I.

[3] Industrial Quarterly Review of Western India (Poona), April, 1894.

system had taught capital to "swim with cork jackets" and hence the inevitable result was to create a feeling of distrust and check the spirit of free enterprise.[1] But, viewed broadly, the apparently conservative ways of investment were inevitable : bold projects and new ventures were clearly impossible in a country where labour was scarce in spite of the poverty of the population, where technical experts were practically non-existent and where the general policy of the Government was one of singular aloofness from private enterprise.[2]

We might note here the part played by Indian capital in the industrial development of this period. As has been observed already, except in the cotton textile industry which has always been the stronghold of Indian investors and managers, very little of the capital invested in other undertakings was drawn from the Indian people.[3] This shyness of Indian capital was due to a number of factors. Firstly, people who had money to spare and invest had been used for generations together to high rates of interest obtainable from various forms of pure money-lending, and as such they were disinclined to sink their funds in industrial ventures the return from which was, after all, small and uncertain at the beginning.[4] Even with regard to the success of the

1 The Economist (London), April 2, 1881. The proportion of capital invested in "other companies" to the total invested capital is as follows :

1889-90	7%	1899-1900	8%
1294 95	7.5%	1904 05	6.5%

(Compiled from the Statistical Abstracts for British India).

2 The Economist (London), July 6 and 27, and November 23, 1895.

3 We have no data, however, as to how much, if any, of the invested capital came from Indian sources.

4 Industrial Quarterly Review of Western India (Poona), April, 1894. "It is hard, if not quite impossible, that the capitalist classes of India who from ages past have looked to 10, 12 and 15% interest as legitimate return and where *dama-dupat* and compound rate of interest are the conditions on which loanable capital circulates in the country, could be induced to go into new industries where the return may not only be a bare 5%, but where, at the commencement, there was a probable loss."

cotton mill industry of the Bombay Presidency, it is important to note that much of the flow of Indian capital there was due to the various forms of extra gains (viz., commission, brokerage etc.) in addition to the high interest of 9% charged on advances to the mills by Agents: as a class, the Indian capitalist was slow to move and always bent upon being assured of 9% interest and a good share of profits, before he could be induced to bring his capital into circulation.[1]

Secondly, the average Indian investor was fond more of speculations and commerce than of pure industrial ventures. In many branches of this type of business the Indian had an immense advantage in skill, knowledge of the country, local connexion and cheapness of agency over the European capitalist, and as returns were often bigger and more attractive the former would more readily embark on them rather than buy shares of cotton and jute mills or mining companies.[2]

Thirdly, next to the question of lucrative return, very great importance was attached by the Indian investor to the question of safety and convenience. Acquisition of land and buildings was the favourite form of investment for the moneyed classes[3] while even those who claimed to be less conservative and more enterprising than the rest would at best subscribe to the various loans floated by the Government of India from time to time.[4] Even here, however, the innate conservatism and prejudice of the people stood in the way of

1 *Ibid.*

2 The Economist (London), April 10, 1852.

3 The Indian Textile Journal (Bombay), November, 1905.

4 *Ibid,* April, 1802.

successful loan floatations for a considerable period. For years together money was borrowed by the Government of India on the London market, as it was found that much better terms could be obtained there than in India. The Indian lending classes always expected a high rate of interest on their loans and as money was much cheaper in London it was but natural that a hard-pressed Government should turn there for help in times of financial stringency.[1] It was not until the latter part of the century when the rupee exchange began to fall in terms of sterling[2] that the Indian Government started seriously thinking about the comparative expediency or otherwise of raising money in India instead of in England; on loans raised in India a higher rate of interest had to be paid, but a sterling loan added to the Home charges and thus increased the loss on exchange consequent upon the depreciation of silver. The point had then to be determined whether the immunity of an India loan (raised, of course, in rupees) from loss on exchange did or did not counterbalance the higher rate of interest to be paid on that loan.[3] Even when the Government had started borrowing in India, however, during the whole period under review the proportion of the registered Rupee debt held by Indians was much smaller than that held by Europeans.[4]

All these point to the fundamental obstacle that existed to a greater and more harmonious employment of Indian capital in industrial ventures. The Indian

1 The Economist (London), January 20, 1877.

2 For a most fascinating description of the causes, extent, and effects of the depreciation of silver on Indian currency and finance, see G. Findlay Shirras: Indian Finance and Banking (London, 1920), pp. 113-50.

3 The Economist (London), August 21, 1880.

4 See Appendix II.

investor was still conservative in his outlook, primitive in his ways of business and cautious in departing from his ancestral habits. But it was not the fault of the investor alone: his ignorance, his suspicions, his want of confidence were largely due to the fact that there were as yet few entrepreneurs of a high degree of efficiency and integrity who could command the confidence of an essentially conservative investing class. And in a country where credit is gauged largely by the personal character and business reputation of the individuals who are for the time being conducting an enterprise, distance and want of personal knowledge (which had not yet been entirely overcome) only intensified the general shyness of capital.[1]

It is opportune to consider now the development of banking in India during this period and to examine how far the institutions that existed promoted industrial development. We have seen how the three Presidency Banks were established during the course of the first half of the nineteenth century, how they enjoyed the right of note issue, but how they were directly controlled by Government and the scope of their business was restricted by their Charters. This state of affairs continued till 1862 when the Banks were deprived of the right of note issue[2] and, as compensation, were given the use of the Government balances and the management of the Treasury work at the Presidency towns and their branches. The old statutory limitations on their business were at the same time greatly relaxed, though the

1 The Economic Journal (London), December, 1908.

2 By a subsequent agreement of the same year, however, they were authorised to transact the paper currency business as agents of Government. This was placed under the direct management of the Government in 1866.

Government's power of control remained unchanged.[1] On the whole, these three Banks were well equipped (at least up till the end of the third quarter of the century) to deal with the requirements of Indian trade and industries; and often they had surplus money which they did not know what to do with.[2] It was under these circumstances that the failure of the first Bank of Bombay occurred in 1866.[3] The primary cause of the failure was unemployed money: people had in their hands capital for which they did not perceive any legitimate vent and for which their ordinary channels of investment afforded no outlet, and so they hunted out new schemes and the most alluring of visionary ideas.[4] "Capital was forthcoming for anything and everything - for the most colossal bank as well as for the most modest and tiny brick-and-tile company...and there was always a vast difference between the nominal capital and the capital actually paid on the shares subscribed."[5] Divers monetary concerns sprang up like mushrooms between 1863 and 1865 and many "triangulated concerns" were instituted.[6] Bombay went mad; a whole list of unfamiliar names attracted the eye: "Back Bays," "Mazagons", "Freres", "United Victorias", "Colabas",

1 Report of the Controller of the Currency for 1920-21 (Calcutta, 1921), p. 30.

2 The Economist (London), June 10, 1865.

3 For a detailed account of the causes and circumstances of this failure, see Report of Commissioners appointed to enquire into the failure of the Bank of Bombay. (House of Commons Papers, 1869, Cmd. 4162.)

4 The Economist (London), June 10, 1865.

5 D. E. Wacha: A Financial Chapter in the history of the Bombay City (Bombay, 1910), p. 33.

6 Wacha: *op. cit.*, pp. 24-36. A typical "triangulated concern" was the Asiatic Bank helping to promote the Old Financial by advancing on Financial's shares; this in turn promoted the Reclamation Company!

almost without limit, and forming a study and a branch of investment in themselves; land-speculation reached unusual proportions and sudden accessions of wealth became a regular feature in the life of the city. But soon the imaginary values set on untried adventures faded away; no kind of shares could be sold in the market and local credit was completely deranged. At the apex of all this stood the Bank of Bombay which, owing to the relaxation of sound old restrictions[1] and the ascendancy in the Bank parlour of some careless and perhaps unscrupulous Directors, had made imprudent advances on questionable securities; on the other hand, the public had been led to imagine that the Bank was a carefully managed state institution while in reality it had grown to be no better than "a carelessly managed joint-stock loan office." The result was that during the boom period both the speculators and the public went on merrily with their "adventures", and when the inevitable crash came and confidence was shaken, it carried the Bank of Bombay along with it.[2]

The immediate effect of the failure of the Bank of Bombay was a general apprehension on the part of Government of any connexion with any banking business. Gradually, however, it became clear that the

[1] The Bankers' Magazine (London), August, 1869. The old Act (of 1840) prohibited the discount of negotiable securities, unless two persons or firms unconnected in partnership were bound by such security; the new Act (of 1863) allowed the discount of any negotiable security. The former prohibited any advance on bank shares or any certificate of shares; the latter allowed advances on the security of shares in public companies in India and did not require that all the calls on such shares should be paid up, or prohibit advances on the premia of shares. The old Act prohibited all advances (except loans on the security of Govt. paper, bullion or imperishable goods) for a larger amount than three lakhs of rupees or for longer than three months, but the new Act (of 1863) contained no such restrictions.

[2] The Economist (London), July 3, 1869.

crash of 1866 was due to certain defects in the rules governing the affairs of the Bank, and so by the Presidency Bank Act of 1876 nearly all the most important limitations of the earlier period were reimposed on all the three Banks.[1] The Banks were prohibited from conducting foreign exchange business, from borrowing or receiving deposits payable out of India, and from lending for a longer period than six months or upon mortgage or on the security of immoveable property or upon promissory notes bearing less than two independent names or upon goods unless the goods or the title to them were deposited with the bank as security. At the same time Government abandoned direct interference in the management, ceasing to appoint official directors and disposing of their shares in the Banks. The Banks no longer enjoyed the full use of the Government balances; Reserve Treasuries were constituted at the Presidency towns into which surplus revenues were drawn, and the balances left at the disposal of the Banks were henceforward strictly limited. This system continued only with minor modifications until 1921.[2]

On the whole it seems that the three Presidency Banks and other banks of the Exchange group were adequate for the organised industrial and commercial needs of the country during the first half of our period. The fundamental disequilibrium which we have noticed before lay more in the imperfect economic development of the country than in its banking organisation. And this former factor continued to hinder a harmonious banking development even during the latter half of

1 The second Bank of Bombay was established in 1868.

2 Report of the Controller of Currency for 1920-21 (Calcutta, 1921), pp. 30-31.

the nineteenth century. The confusing growth of banking establishments continued at a slow pace, but both the size and the number of the new institutions were small.[1] It is no wonder that progress was so slow, for, as things stood, there were hardly any opportunities for employment of more funds in profitable enterprises. In 1866 the Agra and Masterman's Bank—an institution of great repute—failed, and one of the causes of its failure was the vicious combination, within itself, of several branches of business which should have properly belonged to an institution other than a bank.[2] The collapse of the first Bank of Bombay had also been due partly to imprudent advances on questionable securities. In 1864 a project called the East India Financial Association was mooted with a view to granting loans on the security of lands (which did not come within the limits of pure banking business), but it soon failed owing to the lack of proper avenues for the employment of money.[3] Some years later another institution called the Land Mortgage Bank of India, Ltd., was brought into being, but soon its Chairman began to complain of the want of demand for loans, and after a few years' struggling existence this "Bank" withdrew from all loan business and directed all its attention to the development and extension of its own tea-estates.[4] All these facts seem to prove that it was the absence of suitable investment facilities that continued to hamper a proper banking

1 J. M. Keynes: Indian Currency and Finance (London, 1924), p. 222. Between 1870 and 1894, only 7 banks of any importance were founded with only 5 lakhs of paid-up capital.

2 The Economist (London), June 9, 1866.

3 The Bankers' Magazine (London), May, 1864,

4 The Bankers' Magazine (London), June, 1872; October, 1875; Junuary 1877. The Chairman's address of 1872 contained the remark: "There is such a plethora of money in the Indian markets......"

development rather than that the inadequacy of banking houses hindered industrial and commercial enterprises.[1] The Bank Act of 1876, for instance, (against which much criticism was levelled in later years) was designed to encourage the growth of banking on sound and healthy lines in a conservative country like India, to save the banks from speculative business and to incorporate the experience and practice of English banking in India ; and subsequent events showed that it performed these functions fairly well in the midst of the most embarrassing currency difficulties that threatened the financial life of India during the whole last quarter of the nineteenth century.[2]

In the last quarter of the nineteenth century industrial development in India was faced with two formidable difficulties. The first was the depreciation of silver and the consequent unsettlement of all financial arrangements; the second was the alleged defects of the so-called Reserve Treasury system that had been established by the Act of 1876.

The depreciation of silver and the consequent fluctuations in the exchange-value of the rupee was perhaps the more baffling difficulty.[3] Despite the action

1 Cf. The Banker' Magazine (London), May, 1881.

2 P. A. Wadia and G. N. Joshi : Money and the Money-market in India (London, 1926), p. 207.

3 The gold price of silver and the average rate of exchange during 1875—93 were as follows :

	Average price of silver. (d. per ounce)	Average rate of exchange. (d. per rupee)
1875	58.5/16	22.22
1878	54.13/16	20.79
1881	52.1/4	19.95
1884	50.4/16	19.54
1887	45.3/8	17.44
1890	42.11/16	16.57
1893	39.13/16	14.98

Compiled from Tables in Shirras : *op. cit.*, pp. 122-32.

of the Latin Union and the failure of the monetary conferences of 1878 and 1881, bimetallism continued to be a practical question until 1892 when the failure of the Brussels Conference and desire of the British Government to adhere to monometallism made bimetallism no longer feasible for India. The consequent uncertainty intensified the violent fluctuation in the exchange rate of the rupee and affected trade in India by making it more subservient to exchange and less responsive to supply and demand; it restrained sterling capital from flowing to India owing to the prospect of redemption at a loss; and it made the fiscal policy of the Indian Government the sport of the elements.[1] Banking activities were often reduced to mere gambling on chance, and the keen competition for exchange business (which began to attract a lot of attention about this time owing to the possibility of obtaining big prizes) diverted a great deal of attention of the banks from purely industrial ventures.[2] A despairing note marked the measures taken by most of the Finance Members in India and it is no wonder that the question of pure banking development was shelved in the face of the great problem of currency depreciation.[3] The Indian Famine Commission of 1880

1 The Bankers' Magazine (London), February, 1911.

2 The Economist (London), April 22, 1882.

3 Sir Auckland Colvin in his Budget statement of 1885-86 said :

"We could have provided for our famines, we could have met our increased military expenditure, our increased expenditure for our frontier railways, for our coast defences and for our frontier works, and we could have left the provinces to their career of steady prosperity without anxiety and almost without difficulty, if we had been able to carry out our calculations in a medium which possessed some stability......But it is fruitless to persist in economies, to abandon or delay works of which the necessity has been demonstrated, or to devise sources of increase to our revenue, if the result of economy, prudence and taxation alike disappear in the great gulf of exchange." (The Economist, London, May 1, 1886).

had spoken of the "introduction of a diversity of occupations" as one of the root remedies of famine,[1] but the attention of the Government of India was more than occupied with the problems of currency and exchange. In 1893, on the recommendations of the Herschel Commitee,[2] the Indian mints were closed to the free coinage of silver and arrangements were made for the adoption of a gold standard, but no irrevocable steps were taken until another Commitee was asked to examine the position and report. This Commitee, popularly called the Fowler Commitee, recommended, in 1898, the effective establishment of a gold standard[3]; and the Government of India did their best to carry out their recommendations, but circumstances were too strong for them. Still, a gold exchange standard had been firmly secured without a gold currency, and when the Chamberlain Commission reviewed the whole situation in 1913-14 they came to the definite conclusion that in the absence of any well-developed banking organisation, the new system was admirably adopted to the needs of India on account of its cheapness and convenience.[4]

The vagaries of exchange and the consequent uncertainty of the monetary and financial policy of the Government of India affected banking and industrial development in two principal ways. First, it made

1 Report of the Indian Famine Commission, Part II (House of Commons papers, 1880, Cmd. 2735).

2 Report of the Indian Currency Committee (House of Commons papers, 1893, Cmd. 7060).

3 Report of the Indian Currency Committee (House of Commons papers, 1898.)

4 For a detailed account of the sequence of events, see Report of the Royal Commission on Indian Currency and Finance (House of Commons papers, 1914, Cmd. 7236).

external trade and commerce a very risky and speculative business and consequently retarded the free flow of capital from England into India; and this slackness affected industrial development as well, because British capitalists hesitated to invest money in a country where financial and monetary policy was so fickle and uncertain. Secondly, the formidable problems of Indian currency and exchange took up most of the time and resources of the Government of India, and made it difficult, if not impossible, for them to consider the wider problems of the financial requirements of Indian industries in a broad and comprehensive way.[1]

We should now turn our attention to the other formidable difficulty of this period which seemed to hamper industrial finance. This was the so-called Reserve Treasury system. The Presidency Bank Act of 1876 had deprived the three Presidency Banks of the right of enjoying the full use of the Government balances and had constituted Reserve Treasuries at the Presidency towns into which the surplus revenues were drawn; only certain fixed minimums were to be kept at the head offices of the Banks under agreement with the Government[2] (although in practice the Government of India often kept considerably larger sums at these head offices), while the rest of the surplus funds was deposited in the three Reserve Treasuries and the numerous district treasuries of the Government of

1 The Journal of the Institute of Bankers (London), October, 1901.

2 These were :—

At the Calcutta Office of the Bank of Bengal	...	£ 233,300
At the Bombay „ „ „ „ of Bombay :	...	£ 133,300
At the Madras „ „ „ „ of Madras :	...	£ 120,000

India.[1] Now, the accumulation of specie and idle money in the treasuries of India had been a cause of complaint on the part of traders and industrialists ever since the days of Dalhousie.[2] The Act of 1876, in so far as it stamped the Reserve Treasury system with permanence, only gave causes for further complaints. The locking up of money in treasuries which Government did not consider safe to deposit with their bankers certainly reduced the monetary resources of the country; and although branches of the Presidency Banks were regularly used for keeping treasury balances in the comparatively few places where such branches existed, in general Government's balances at these branches of the Banks seldom exceeded immediate requirements to any great extent. The Government's policy was, as a general rule, to draw any surplus balances to certain centrally situated treasuries and finally to the Reserve Treasuries; and so, in practice, whatever surplus Government balances there might be in India at any time tended to accumulate in the Reserve Treasuries.[3] This increased monetary stringency in India and could not fail to have an injurious effect on her trade and

[1] The figures for 1879-80 to 1887-88 were as follows :

	1879-80	1882-83	1885-86	1887-88
In the three Presidency Banks ... ... Rs.	1,73,08,000	1,39,44,000	1,35,73,000	1,36,72,000
In the three Reserve Treasuries ... Rs.	57,12,000	2,33,90,000	87,98,000	71,87,000
In district treasuries ... Rs.	10,72,75,000	11,08,82,000	10,51,74,000	11,78,54,000

The corresponding figures for 1911-12 were £ 2,983,000, £ 3,506,000 and £ 5,790,700 respectively. (Compiled from the Bankers' Magazine, London, July, 1889, and Report of the Royal Commission on Indian Currency and Finance, 1914).

[2] *Vide* The Economist (London), January 7, 1854.

[3] Report of the Royal Commission on Indian Currency and Finance, 1914, p. 34.

industry.[1] The disadvantages of the system were accentuated by the special conditions of India where business is subject to a seasonal tide of strongly marked character: the season of maximum collection of revenue coincided with the season of busiest trade and thus it happened that, at the time when the market stood most in need of funds, the Government were taking off the market quite a few crores of rupees, not for the sake of immediate requirements, but in order to meet disbursements during the slack season of summer and autumn.[2]

The Government defence was that in India the resources and transactions of Government bore a very high proportion to those of trade and hence it was of great importance that trade should not be allowed to rely on a false security—upon the support of funds which might have to be withdrawn without notice.[3] Moreover, large deposit accounts with banks were not considered an unmixed advantage by the banks themselves, especially when accompanied by so many restrictions as had been placed by Government on Presidency Banks.[4] Finally, they argued that the average bank rate in India was not excessive, and that it was always possible for firms and individuals who could offer good security to borrow money from the Presidency Banks all the year round at not a very high rate of interest.[5]

Now, whatever the necessities of the Government were, evidently the independent Treasury system was not an ideal one: it compared unfavourably with

1 The Economist (London), February 10, 1894.
2 Report etc., *op. cit.*, p. 34.
3 The Economic Journal (London), December, 1900.
4 The Bankers' Magazine (London), October, 1885.
5 Report etc., *op. cit.*, p. 35.

the practice in the United Kingdom and in most other countries of the keeping of Government balances at a bank. In India money collected as revenue was necessarily taken off the market and immobilised in the Reserve Treasuries.[1]

It is useful, however, not to attach too much significance to the independent Treasury system, so far as the question of industrial finance was concerned. In spite of the defects of the system and its obvious effects on the money market, it would be rash to assert that the financial needs of Indian industries could not be adequately met mainly on account of the inequities of the system. The promotion of enterprises and the provision of initial capital had nothing to do with the Presidency Banks or the Treasuries, and the real problems were those of management, enterprise and efficiency.[2] The Government could not justly be accused of sitting on funds that could safely be lent to industrialists and manufacturers,[3] and it is significant to note that most people, when speaking of monetary stringency, confused "currency" with "loanable capital."[4] It is significant also that none of the Industrial Conferences which met form year to year in the different cities of India ever spoke of the "problem" of industrial finance during this period.[5] Their main topics of discussion were the neglected industries of India, the question of technical education, the absence of protection, the difficulty of

1 *Ibid*, pp. 34-36, for a critical and detailed discussion.

2 The Indian Planters' Gazette (Calcutta), December 15, 1885, and January 26, 1886.

3 The Economic Journal (London), December, 1900.

4 Cf. The evidence of Mr. W. H Cheetham before the Fowler Committee (1898).

5 The First Industrial Conference was held at Poona in 1891.

finding a suitable and intelligent labour force and so forth. Even the Bombay Millowners' Association, that great champion of economic nationalism in India, hardly ever spoke of the difficulty of obtaining capital either for the promotion or for the expansion and continuance of a cotton mill.[1]

In the absence of evidences to the contrary, we cannot, therefore, help coming to the conclusion that even during this period the problem of industrial finance had not presented itself to any appreciable extent. In reality, it was a period of domination by foreign capital and the foreign capitalist did not rely on the Indian capital market for the promotion of his ventures. Being on secure foundations, he encountered no difficulty in getting advances from the Presidency and Anglo-Indian banks for his working capital: he had both standing and security, the *sine qua non* of success in business.[2] The problems that confronted industry were mainly those of enterprise, management and labour, and here the Managing Agency system proved a useful and expedient innovation to cope with the peculiarly difficult circumstances of India.

On the other hand, Indian capital played a very minor part in the economic development of India during this period. We have noticed before how and why Indian capital was so shy all these years and also how the success of the Bombay cotton-mill industry was due to certain special features of finance and enterprise in Bombay which did not exist in other parts of India. The time was

[1] See The Indian Textile Journal (Bombay), June, July and September, 1891; September, 1893; September, 1895; February, 1899; March, 1901; May, 1901; May, 1905; and April, 1911.

[2] The Indian Textile Journal (Bombay), January, 1907.

not yet ripe for extensive employment of Indian capital in industrial ventures : stimulus was needed to awaken enterprise and business ability first, and until these latter qualities were actively forthcoming, capital could afford to remain comparatively shy without causing any serious disharmony in the economic development of India.

As the years rolled on, however, to the beginning of the twentieth century, certain new factors seemed to alter the whole complexion of the situation. The year 1905 may very properly be called the end of an era in the economic history of India. It saw the full effects of railway development in India. Throughout the end of the nineteenth century railways had been the target of attack from Indian nationalists on the ground that they were costly, unprofitable and badly managed. It was not until the opening years of the twentieth century that railways began to show a surplus to their credit and the full signaficance of the linking up of the country by these lines of communication was appreciated.[1] Secondly, it was about 1905 that the economic policy of the Government of India began to undergo a new orientation. Currency and financial problems had been fairly solved, or, at least, were on the way of being solved, and the Government of India could now turn their attention to encouraging Indian enterprise in the industrial and business sphere. When Lord Curzon spoke in 1899 of the backward state of Indian banking, he was voicing the genuine concern of an intelligent bureaucracy.[2] Although

[1] For details, see Report of the Committee on Indian Railway Finance and Administration (House of Commons Papers, 1908, Cmd. 4111).

[2] Speech of Lord Curzon before the Imperial Legislative Council (September, 1, 1899) : "In respect of banking it seems to me we are behind the times. We are like some old-fashioned sailing ship, divided by soild wooden bulkheads into separate and cumbrous compartments. This is a state of affairs which, it appears to me, can hardly continue."

the policy of non-intervention in the development of Indian industries was generally pursued up to 1914, the opening years of the century saw the sincere attempts of local Governments to encourage economic enterprise.[1] Finally, this year saw the rise of the Indian nationalist movement[2] and a direct consequence of this was the flow of Iudian enterprise in the organisation, management and finance of India's own industries. As difficulties began to be encountered, criticism was levelled at the banking and financial policy of the Government of India and people began to ask themselves why capital was so shy and industrial development so sluggish.[3] It was then that the problem of the supply of funds, both for block and working capital of industries, began to assume its truly modern proportions. The year 1905 opened the flood-gates of Indian enterprise and made people ask whether it was the paucity of suitable banking establishments that hampered industrial finance or whether it was the absence of business enterprise that prevented a harmonious growth of banking institutions.

1 The Indian Central Banking Euquiry Committee (Majority Report), Calcutta, 1931, p. 261.

2 Roberts: *op. cit.*, pp. 549-52.

3 The Economist (London), May 27, 1911.

CHAPTER VII

THE EMERGENCE OF THE "PROBLEM" OF INDUSTRIAL FINANCE IN INDIA

We have seen how, in various ways, the year 1905 was a turning point in the economic history of India. It was about this time that Sir (then Mr.) Dorabji Tata came across the famous iron ore deposits at Sakchi. After preliminary investigations he went over to England with the idea of raising the requisite capital in London. British experts reported very favourably upon the quality of the ore, were satisfied with the immense quantity available and expressed the view that it could be very cheaply converted into pig iron and made into high-grade steel. But the British money market would not respond: there was a general reluctance about making investments in India and it was a period of acute depression in the money market; moreover, there were differences about the degree of control which was to be given to the representatives of the British investors.[1]

The Tatas who had spent months in the City of London without avail now returned to India and conceived the bold idea of appealing to the people of India for the requisite capital.[2] A circular was issued and was followed by the publication of a prospectus in 1907. There was a tremendous response from the people of

[1] F. R. Harris: J. N. Tata, a chronicle of his life (London, 1925), pp. 200-02.

[2] According to some this appeal was made on the suggestion of Lord Sydenham, then Governor of Bombay. *Vide* The Times (London) Obituary Notice, June 4, 1932.

India. "From early morning till late at night the Tata offices in Bombay were besieged by an eager crowd of native investors. Old and young, rich and poor, men and women, they came offering their mites; and at the end of three weeks the entire capital required for the construction requirements, £ 1,630,000, was secured, every penny contributed by some 8,000 native Indians. And when, later, an issue of debentures was decided upon to provide working capital, the entire issue, £ 400,000, was subscribed by one Indian magnate, the Maharajah Scindhiah of Gwalior".[1]

The flood-gates of India enterprise had been opened and the floatation of the Tata scheme was but the prelude to the perceptible quickening of interest, on the part of thoughtful Indians, in the matter of the industrial re-organisation of the country. When the Tata Hydro-Electric Scheme was launched in 1910, all the capital was again subscribed by Indians alone. So long the cotton-mill industry had been the only stronghold of Indian capital and organisation, but the *Swadeshi* movement in and after 1905 began to have important consequences on the economic development of India. Capital now began to flow into diverse and new enterprises and the number of joint-stock companies registered and at work in India increased by leaps and bounds. In the nineteenth century most of the large-scale enterprises had an exotic origin, as it were, but as the years rolled on in the present century, investments became more conscious and enterprises more planned.[2] Thus, although coal-mining had started in India towards the last quarter of the nineteenth century,

[1] Harris: *op. cit.*, p. 202.

[2] P. P. Pillai: Economic Conditions in India (London, 1925), p. 185.

it was of little importance as an occupation even towards the closing years of the century. The interest of the Indian people had, however, been aroused by the *Swadeshi* movement and companies with Indian capital, and frequently with Indian management, began to be formed. The same tendency could be seen in the petroleum industry and in the various branches of iron and steel industries.[1] The engineering and allied industries were not also exempt from this new influence, and even in the jute mills, although the management continued to be European (mostly Scottish), the shares came to be increasingly held by Indians. The cotton textile industry, too, experienced a great fillip and became, from an essentially spinning industry, exporting more than half its production, a weaving industry using imported yarns in its products.[2] By 1914 India had become the fourth greatest cotton manufacturing country in the world. In tea also both acreage and production increased tremendously and in the world's market the Indian tea industry got far ahead of China.[3] Nor was it the case that Indian enterprise and capital were confined to certain stereotyped industries. Woollens, silk, paper, matches, cement, brick and tiles, tobacco, hides and skins, sugar and a host of other enterprises now began to attract Indian money and Indian brains and soon people became faced with the practical problems of finance and management in each of these enterprises.

Two factors, besides the *Swadeshi* movement, helped to accelerate the industrial re-awakening of India. The first was the improved position of the railways in

1 For details see the First Report of the Indian Tariff Board on the Steel Industry, 1924.

2 Indian Finance Year-Book (Calcutta), 1933, p. 218.

3 *Ibid*, p. 228.

India. Up to the end of the nineteenth century the State had to bear an annual net deficit on the lines under its control and it was only in 1899-1900 that a net profit was, for the first time, earned. With this the wild criticisms of the people about the introduction of railways in India lost much of their force, and Indians of all shades of opinion began to realise that railways have been one of the primary factors tending to overcome the arrested economic development of India, and perhaps the principal stimulus towards economic unification.

Most important of all, however, was the second factor, viz., a new orientation in the industrial and economic policy of the Government. So far all that the Government had done to aid industry had been to provide a cartain amount of technical and industrial education and to attempt to collect and disseminate commercial and industrial information.[1] Beyond this, the doctrine of *laissez faire* had dominated all the activities of the Government and it became almost a settled policy to say that Government was ill-qualified to further industrial development by any direct action.[2] As the years rolled on, however, a more progressive policy was adopted. A separate Imperial Department of Commerce and Industry was created in 1905 and gradually Provincial Departments of Industries were started in the provincial units. The policy of non-intervention was, however, generally pursued till the outbreak of the Great War and very little could, therefore, be achieved owing to the lack of a definite and accepted

1 Anstey: *op. cit.*, p. 210.

2 Report of the Indian Industrial Commission, 1916-18 (1919, Cmd. 51), p. 6.

policy and to the absence of an appropriate organisation of specialised experts.[1]

Events of the War and post-war boom accelerated the change in the policy of the Government. The demand for Indian manufactured goods increased enormously during the war years, partly because certain foreign imports were completely eliminated from the Indian market and partly on account of the new war demand from Indian troops and from England. A new constructive economic policy was, therefore, almost forced upon the Government and the Indian Industrial Commission was appointed in 1916. Meanwhile, the Indian Munitions Board was established primarily to control the purchase and manufacture of Government stores and munitions of war. This Board took upon itself the direct manufacture and purchase of requirements for the military, civil and railway departments, diverted orders from abroad to India through the priority and indent system, assisted firms to import machinery, find export markets and obtain skilled labour in new industries, collected data and disseminated information, and undertook investigations and laid plans for the establishment of industries new to India.[2]

The Industrial Commission presented its report in 1918. It analysed how the East India Company had primarily been a trading corporation whose rôle was to exchange as far as possible the manufactured goods of England for the products of India and how, in the absence of scientific and technical advice, most of the sporadic efforts to launch new enterprises had ended in

1 *Ibid*, p. 74.

2 Handbook of the Indian Munitions Board (Calcutta, 1919), p. 8.

failure up to the closing years of the nineteenth century. It recognised that the fundamental guiding principle should in future be that "the Government must play an active part in the industrial development of the country with the aim of making India more self-contained in respect of men and material", and it pointed out that the most important fact about capital was that it was generally confined to a few simple and safe industries of an obviously attractive nature "while equally well minor industries had been almost entirely neglected, partly through ignorance of the country's resources in raw materials, but mainly because commercial firms had prospered too well along conservative and stereotyped lines to trouble about undeveloped industries with uncertain prospects."[1] It noted that banking facilities did not exist at all for the agriculturists and smaller industrialists in the mofussil and that the only financier there was the *mahajan*; on the other hand, investment in land by purchase or mortgage still appealed strongly to professional men and Government officials, and agriculturists followed the traditional way of sinking their money in jewellery for womenfolk, and in hoards. In the Presidency towns, however, a much larger proportion of transactions took place through banks and there was a greater readiness on the part of some sections of the public to invest. Even here, although many industrialists of standing, European and Indian, seemed to experience comparatively little difficulty in obtaining capital for any well-considered proposal which they were able to put forward, there was a general grievance that the credit system was too inelastic to meet the genuine needs

[1] Report of the Indian Industrial Commission, pp. 46-65.

of trade and industry and that development was retarded because banks refused to advance money for lengthy periods to all enterprises whether old or new.[1]

The recommendations of the Industrial Commission were extremely wide and comprehensive in character. The question was one of organisation, and according to the Commission's recommendations, the main activities of Government in respect of industries were to include research, industrial and technical education, commercial and industrial intelligence, direct assistance, technical and financial, and the purchase of stores. As, however, under the Reforms of 1921 the main responsibility for the development of industries by the State passed to the Ministers in the provinces, complete effect could not be given to the Commission's recommendations by the Government of India. Moreover, financial difficulties and the limitations imposed upon the spending powers of Ministers by the diarchical form of constitution operated as impediments in the way of translating the wishes of the Commission into reality.[2] Nevertheless, in 1921 a permanent Imperial Department of Industries was set up, and in 1923 the Indian Legislative Assembly passed a resolution appointing a Tariff Board in accordance with the recommendations of the Fiscal Commission and adopting a policy of discriminating protection. Articulate India hailed these measures as steps in the right direction, and although in the enthusiasm of having attained the long-cherished ideal of fiscal autonomy the manifold and intricate questions besetting the problem of a harmonious economic development tended to be

[1] *Ibid*, pp. 176-178.

[2] Report of the Indian Central Banking Enquiry Committee (Majority Report), 1931, p. 263.

forgotten, a great point had been scored and the energies of Indian politicians and economists could now be devoted to the larger questions of management, finance and labour supply.

The question of capital and credit had now come to the forefront of economic discussions. It will be useful at this stage to take stock of the banking situation in the country. The wave of *Swadeshism* had led to an era of rapid expansion of joint-stock banking, but most of these banks were unwilling to build up their business in the usual "slow but sure" way. It was a confusing group that sprang up: there was a great number of money-lending establishments registered as banks under the Indian Companies' Act; there were the regular banks having a paid-up capital and reserve of over five lakhs each; there were banks offering sensational rates of interest on deposits and there were banks that did nothing but speculation.[1] It was no wonder, therefore, that the collapse came in no time—in 1913-15. Speculation, precarious advances, want of skill in management and a host of other factors wiped a larger number of mushroom banks out of existence and a considerable amount of capital was thus thrown to the winds.[2]

In the years immediately before the War the agitation against the inequity and inconvenience of the Reserve Treasury system gained in volume and strength. The Royal Commission on Indian Currency and Finance, appointed in 1913, examined the system in all its aspects and came to the conclusion that the question was not

[1] J. M. Keynes: Indian Currency and Finance (London, 1924), pp. 221-224.

[2] G. Findlay Shirras: Indian Banking and Finance (London, 1920), p. 365.

one of wholesale surrender of Treasury funds to the Presidency Banks, but one of "the discretionary disposal of them in periods of stringency." They scented danger in making over the funds to the Presidency Banks as that might induce the somewhat restricted money market in India to rely too much on Government funds, and as an alternative they suggested that Government itself should make loans from their balances on good security and for short periods. They recommended that in the first instance such loans should be confined to the Presidency Banks and they hoped that through the latter any benefit in easier rates that might accrue would find its way to other users of money.[1] As, however, the War broke out shortly after, no effect could be given to the Commission's proposals.

The Reserve Treasury system was, in comparison with other problems ahead, no more than a minor issue. From the standpoint of Indian industry and trade the root of the trouble was that India suffered not from a high *average* bank rate, but from a wide range of fluctuations and a high maximum bank rate. "If the *average* bank rate were high, this would mean that the normal return to capital under conditions of least risk were high, and this could not possibly be cured by any monetary device." But a high temporary bank rate meant that an increased volume of cash was temporarily required in certain seasons for industry and trade, and this could be ameliorated only by introducing an elasticity into the currency and credit machanism of the country. There was, however, no suitable machinery to carry out the task and Mr. J. M. Keynes

[1] Report of the Royal Commission on Indian Currency and Finance (1914), Cmd. 7236, pp. 30-37.

pointed out the solution in his brilliant memorandum to the Commission. He urged the establishment of a State Bank in India which, he emphasised, would be able to moderate the existing wide fluctuations of bank rate and its normal high level in the busy season, and also introduce re-discount facilities into the Indian market.[1] Nothing could, however, be done in this direction either as the War broke out soon after.

The question of banking and its relation to the financial requirements of industry had thus come at last to the forefront of economic discussions. Even the Babington Smith Committee of 1919-20, appointed "to make recommendations with a view to ensuring a stable gold exchange standard", could not escape the fact that the banking and currency problems of India were far more interdependent than they seemed to be.[2] In a statement before the said Committee on behalf of the Government of India Mr. M. M. S. Gubbay pointed out that figures showing an increase in bank deposits or in the number of cheques drawn from banks did not necessarily indicate anything like a corresponding increase in banking habits, and that a considerable part of trade and industrial operations in India was financed by the indigenous banking system with no cheque books at all.[3]

About a year after this, in 1921, the three Presidency Banks were amalgamated to form the "Imperial Bank of India"; provision was made in the Imperial Bank Act of 1920 for an increase of capital, and although the restrictive and regular clauses of the Presidency Bank Act of 1876 relating to the class of business in

1 Annexe to above, p. 79.

2 Report of the Committee on Indian Exchange and Currency, 1919. *Vide* the Minority Report by Mr. D. M. Dalal, para 78.

3 Statement by Mr. M. M. S. Gubbay, *ibid.*

which the Bank may engage were retained, the Reserve Treasury system was abolished and the management of public debt was handed over to the new Bank.[1] No doubt the sphere and functions of the Imperial Bank of India did not exactly coincide with those of a Central Bank under the strictest definition of such an institution in countries with a highly developed banking system and a central discount market, but conditions in India were different and as such necessitated evolution on other lines. In India the complete foundations had still to be laid and Government had to build up from the base.[2]

Nevertheless, the demand for a thorough examination of the credit system of the country continued unabated. The cautious and calculating attitude of Government towards industrial development combined with instances of anomalies in the fiscal, railway and stores purchase policies till recently followed, exposed the Government to the charge of open hostility towards the interests of Indian industries prompted by the over-riding consideration of advancing British interests. Moreover, there was a general feeling that the progress made by India in her industrial development during the last fifty years was very meagre compared with her vast resources and the needs of her large population. "India produces nearly all the raw materials necessary for the requirements of a modern community, but is unable to manufacture many of the articles and materials essential alike in times of peace and war." According to many, the capital, enterprise and skill of England exercised a paralysing influence over the trade and manufactures of India and Government did not

[1] Report of the Controller of the Currency for 1920-21 (Calcutta, 1921), p. 22.

[2] H. F. Howard in " The Economic Journal ", June, 1921.

venture to interfere as the vested interests were too strong for them.[1]

It was in these circumstances that the External Capital Committee was established in 1925 "to consider the question of the flow of capital into India from external sources." The Committee came to the conclusion that the use of British capital had saved fruitless expenditure of indigenous capital in a number of risky concerns and that it was all to the good of India that initial costs of development had been borne by British capital. Nevertheless, it recognised that there was sufficient potential capital in India to meet the larger part of India's industrial requirements, but that it was timid, conservative and required to be drawn out. The best way of securing the internal potential capital for the needs of Indian industries and trade was, in the opinion of the Committee, to increase facilities for deposit and investment, to take a more active part in watching over the development of banks and to give more investment facilities in the way of wider advertisements of State loans in the principal vernaculars of India. Finally, the Committee recommended that a comprehensive survey of banking organisation and credit facilities in India was urgently required.[2]

This banking survey was, however, put off by the Government of India till 1929 for a variety of reasons. Meanwhile, Indians began to point out the marked contrast between the attitude of the State towards industries in India and that in certain other countries like the United States of America, Germany and Japan. The very fact that more than three-fourths of capital investments

1 Banking Enquiry (1931), Majority Report, pp. 261-264.

2 Report of the External Capital Committee (Simla, 1925), pp. 1-7.

in India was confined to capital outlay, debts and loans, and that of the remainder nearly a third was locked up in jute, cotton and woollen mill industries and in mining made people ask if the financial assistance obtained by promoters of industrial enterprises was adequate or not.[1] It was argued that the practice of obtaining much of the working capital, if not the fixed capital, from short-term deposits of people who treated some of the industrial concerns as banks was unhealthy in itself. The risk of sudden demand, the undue narrowing of the market for the supply of good industrial securities as a result of the short-term deposit system, and the possibility that severe losses might occur in a crisis or a panic owing to money lent on short deposit being locked up in fixed capital assets, tended to inhibit enterprise in India.[2] When acute depression came in 1924-26 many of the old cotton manufacturing companies of Bombay were involved to the extent of crores of rupees through this pernicious system. Many of the mills changed hands and this system of finance began to break up. But this disintegration tended to produce exactly the same difficulties which the disappearance of an old established financial prop might be expected to produce. Loud, therefore, grew the clamour for the setting up of specialised financing agencies on the lines of Germany or Japan and people began to talk as if a few such institutions would cure all the industrial ills of the country.

Despite alleged handicaps and the lack of any support from the Government, however, considerable progress had been made in the matter of industrial devel-

1 Shirras: *op. cit.*, p. 392.

2 P. N. Wadia and G. N. Joshi: Money and Money Market in India (London, 1926), pp. 383-85.

opment in India. The number of joint-stock companies at work registered in India with rupee capital had increased from 1,309 with a paid up capital of Rs. 29 crores in 1 95-96, to 5,189 with a paid up capital of Rs. 231 crores in 1921-22, and to 7,328 with a paid up capital of Rs. 283 crores in 1930-31.[1] Some further idea of this development can be obtained by examining the position in regard to some of the principal industries, viz., cotton, jute, iron and steel, coal and tea. Thus, the total production of cotton mills had increased from 694 million lbs. in the case of yarn and 404 million lbs. in the case of woven goods in 1921-22 to 867 million lbs. and 590 million lbs. respectively in 1930-31. In the jute mill industry the number of looms and spindles employed had increased from 43,025 and 908,359 in 1921-22 to 61,834 and 1,224,982 in 1930-31. The production of coal increased from 19 million tons in 1921 to 24 million tons in 1930 and that of iron-ore jumped from 942 thousand tons in 1921 to 1,850 thousand tons in 1930. And in the tea-industry the number of joint-stock companies increased from 401 with a paid up capital of 8 crores of rupees in 1921-22 to 481 with a capital of 13 crores of rupees.[2]

An idea of the industrial progress can also be had from the development of the Stock Exchanges in Bombay, Calcutta and Madras. In Calcutta and Bombay there was no regular organisation in the nineteenth century and business was done in the alleys of the business quarters without any rules or regulations except those arising out of the established customs of those cities. A mercantile exchange called the Royal Exchange was established in 1893 in Calcutta and the Calcutta Stock Exchange Associa-

1 See Appendix III.
2 See Appendix IV.

tion was formed in 1908. In Bombay the old share bazaar was established in 1899, but it was not until a number of years after that a general share bazaar or Stock Exchange and a special Cotton Exchange came into being. The Madras Stock Exchange was founded in 1920.[1]

Against these indexes of economic progress were certain disquieting features that gave rise to a strong feeling among the Indian intelligentsia that the control and management of Indian industries should, to an increasing extent, be confined to Indians. Although there had been a marked increase in the amount of Indian capital invested, it was significant that in 1930-31 there were 882 companies at work in India but registered elsewhere, with a sterling capital of £ 742 millions (Rs. 989 crores), as compared with 7,328 companies with a capital of Rs. 283 crores only registered and at work in India.[2] Moreover, generally speaking, the European Managing Agents did not give any scope to Indians to hold such positions in the companies they managed as might have given these Indians an opportunity to have a comprehensive training in regard both to the technique of production and management of the business.[3] Finally, although the financing of large concerns which had at their back big bosses in close touch with the Home and foreign money markets, had not been a difficult matter, the scarcity of such bosses in India put the manager of a small firm requiring, say, additional capital for development in a position of peculiar difficulty and embarrassment.[4] This,

[1] The Indian Year-Book, 1933.

[2] See Appendix VI.

[3] The Indian Central Banking Enquiry Committee, 1931, Majority Report, p. 264.

[4] Pillai: *op. cit.*, p. 293.

coupled with the fact that the banking system of the country was still "like some old-fashioned sailing ship, divided by solid wooden bulk-heads into separate and cumbrous compartments" made people wonder if a thorough overhauling of the entire credit structure had not at last become due.

So in 1929 the Government of India set up a Central Banking Enquiry Committee "to investigate past records and existing conditions in India including the organisation of the money market, and to consider the steps that were feasible and desirable for the development of banking with a view to the expansion of indigenous, co-operative and joint-stock banking with special reference to the needs of agriculture, commerce and industry, for the regulation of banking with a view to protecting the interests of the public, and for banking education."[1] The enquiry was split up into three stages. In the first stage a number of provincial Committees, with persons possessing intimate knowledge of local conditions, were appointed to deal with the questions of agricultural credit, credit facilities for small industries, mortgage banks, financing of internal trade and stimulation of habits of investment and attraction of banking deposits. After the provincial Committees had reported, an All-India Committee continued the work by making investigation into certain fields of banking excluded from the scope of provincial Committees' enquiry, such as regulation of banking, banking education and credit facilities for India's major industries. When the Central Committee had completed the survey of the whole banking field, the third and the

[1] The Indian Central Banking Enquiry Committee, 1931, Majority Report, p. 5.

last stage was reached when a small body of foreign experts having experience of rural credit and industrial banking in other lands, were appointed to assist the Central Committee in coming to their conclusions.[1] The Central Committee eventually recommended the establishment of provincial Industrial Corporations with a view to supplying financial facilities to industrial concerns in general although they qualified their recommendation by saying that "the advisability of giving assistance to any particular industrial concern should depend on the extent to which the enterprise will be of benefit to the public and will add to the productive power of the province and provide employment for its people."[2]

Thus we see that during the years after the war the question of financing India's industries had become a formidable and insistent problem. Whether the criticisms levelled at existing facilities were justified or not will be examined in due course, but it is clear that vocal India had grown dissatisfied with the *status quo.* Indian entrepreneurs felt, rightly or wrongly, that existing financial facilities were inadequate and unsatisfactory, and realised that "a solution of this could not be found on the mere truism that long-period finance cannot be given from short-period deposits."[3] They felt that banks in India worked very conservatively from the point of view of industrial borrowing and that these institutions could not fully realise their responsibility to industry. On the other hand, the practice of borrowing by short-term private deposits that had grown up in many enterprises by reasons of the absence of adequate banking

1 *Ibid*, p. 3.

2 *Ibid*, pp. 509-10.

3 *Ibid* (Minority Report), p. 325.

facilities (and also because people preferred to entrust their savings to an industrial concern they knew rather than to a bank whose transactions were carried out in a foreign way and whose methods of working were strange and unfamiliar) retarded industrial progress in view of the risks of sudden demand.[1] Entrepreneurs in India, therefore, wanted that either the existing banks should come forward with a bolder and more vigorous policy or that the Government should set up special institutions for the provision of capital and finance to the industries of the country.

1 Wadia and Joshi: *op.cit.,* pp. 395-96.

CHAPTER VIII

The Agencies of the Money Market

We have seen in a previous chapter[1] that although stagnant industry cannot be improved merely by a policy of artificial creation of credit, a very important part is played by the agencies of the money market in co-ordinating the supply of, and formulating the demand for, the financial requirements of industry. Between the group of capitalists who have available supplies of free capital and the group of businessmen and others who employ capital lies the money market, facilitating the movement from one group to the other of the stream of free capital seeking investment. The market facilitates the transfer of this stream by effecting important economies both on the side of supply and on that of demand. Much, therefore, depends on the efficiency or otherwise of the agencies of the money market and also on how far they are co-ordinating and co-operative. Hence we should now consider what the agencies in the Indian money market are in so far as the financial requirements of industry are concerned, and also what part they respectively play in providing capital to these enterprises.

So far as the financial requirements of the major industries are concerned, we may leave out of account the case of Exchange Banks, co-operative banks, land mortgage banks and such organisations as those of *Nidhis* and *Chettiyars*. Although the Exchange Banks

[1] *Supra*, Chapter I.

have got large deposits in India and possess big capital and reserve, their principal business is the financing of India's foreign trade and occasionally of her inland trade. They do not bother themselves about the financial requirements of industries.[1] The co-operative banks, on the other hand, are mostly connected with agricultural credit, and in the few cases where non-agricultural credit societies have been formed the beneficiaries are officers of Government, contractors, small traders, artisans, weavers and so forth. Under the Acts and under the rules of the Co-operative Department, the co-operative banks and societies are debarred, except with the general or special sanction of the Registrar, from lending to anyone who is not a member of the institution; the result is that the financial requirements of the major industries are almost completely outside their purview.[2] Land mortgage banks also have little connexion with industrial finance as they are mostly occupied to meet the requirements of agriculturists for long-term credit for the redemption of mortgages of land, for the clearance of debt and for land improvements, and such organisations as those of *Nidhis* and *Chettiyars* are more or less mutual benefit societies exercising little direct effect on the supply of, and demand for, capital in the general money market.[3]

From the standpoint of industrial finance the most important agencies in the Indian money market are the Imperial Bank of India with its branches, the joint-stock banks, the loan-offices, and the higher class

[1] Indian Central Banking Enquiry Committee (1931), Majority Report, p. 29.

[2] *Ibid*, p. 30.

[3] *Ibid*, pp. 32-34.

of indigenous bankers.[1] Apart from these are the Managing Agents and those depositors from the public who look upon certain firms as banks and deposit their money with them, but strictly speaking they cannot be said to form an integral part of the money market.

Let us start with the Imperial Bank of India.[2] We have seen that this Bank was formed in 1921 by the amalgamation of the three Presidency Banks of Bengal, Bombay and Madras. It is a commercial bank with private shareholders and competes to some extent with other banks. It does the Treasury work of Government free of cost, and, until recently, managed the Indian public debt and provided the machinery for the floatation of loans. Until lately it also acted, to a certain extent, as a bankers' bank: most of the lending banks in India had to keep their cash balances other than till money with it. It has also managed the eleven clearing houses in India; and it has opened branches, under statutory obligation, in different parts of the country. And during the busy season when the Bank rate has been 6 per cent or above, the Paper Currency Department of the Government of India has granted loans to it to an amount not exceeding Rs. 12 crores by transferring to that Department internal bills of exchange or *hundis* of an equivalent amount. In consequence of these responsibilities and privileges the Bank, by the Act of 1920, has not been able to make any loan or advance for a longer period than six months or upon the security of stock or shares of the bank or on the original security of immovable property, nor has it

[1] Insurance companies, too, are gradually attaining importance and some Indian companies invest their funds in shares and debentures of industrials banks and make deposits with, or grant loans to, mofussil banks and loan offices which in their turn often utilise these resources in financing industries (*Ibid*, p. 37).

[2] See Appendix VIII.

been able to discount bills for, or lend or advance in any way to, any individual or partnership firm an amount exceeding at any one time Rs. 20 lakhs except on certain specified securities.[1] It has not also been empowered to discount or advance on the security of any negotiable instrument unless it carried on it the signatures of at least two persons or firms unconnected with each other in general partnership, nor has it been empowered to grant unsecured overdrafts in excess of Rs. 1 lakh. Within these limitations, it has played and still plays its part as the most influential member of the money market: having the biggest share capital and reserve and the largest number of branches all over India, it is the bank to which all other banks have looked for assistance and to which most of the indigenous bankers have applied for help and accommodation.[2]

Next come the Indian joint-stock banks[3] which, apart from the Imperial Bank, are the only organised agencies for providing the financial requirements of the country's industries. These institutions have grown steadily in number and importance during the years after the War. They are all registered under the Indian Companies' Act which imposes no restriction on the business they may do. "The bigger banks perform the ordinary business of banking and, among other services, receive deposits and make loans and advances, including the discounting of bills. They also take part in the movement of produce from the village to the exporting ports and in the distribution of imports from

1 E. g. trustee stocks, funds and securities, securities issued by certain State-aided Railways, the debentures and other securities issued by district boards under the authority of the legislature, and goods or documents of title thereto.

2 These statements are now subject to some modification in view of the recent establishment of the Reserve Bank of India.

3 See Appendix IX.

the ports of entry to the distributing centres. The smaller banks, on the other hand, are generally loan offices which advance money to the professional and and agricultural classes." They take practically no part in the financing of India's foreign trade which continues to be more or less a sort of monopoly of the Exchange Banks. Following the orthodox practice of English banks, they give loans for short periods and against certain forms of security alone and in doing so, they have to depend almost entirely on the resources which they can secure by attracting deposits from people who have money to spare for the time being. The result is that they do not take as important a part in the financing of industries as the German or Continental banks in Europe do.[1]

Let us now examine the actual distribution of commercial credit by the joint-stock banks (including the Imperial Bank of India). "The advances given fall under two main classes : (1) advances against tangible and marketable security lodged or pledged with the lender, and (2) clean advances against personal credit with a second signature to the pro-note." There are very few clean advances against the personal credit of the borrower only—a class of advances that occupy an important place in the highly developed banking systems of Europe and America.[2]

The most popular from of borrowing in India is the cash credit account "under which an advance is allowed against a promissory note signed by the borrower and secured by the hypothecation of stocks." Under this system, "interest is paid by the borrower only to

[1] *Ibid*, pp. 374-75.

[2] *Ibid*, p. 381.

the extent to which the credit is availed of from day to day and he can reduce his obligation at any time subject in some cases to a minimum interest clause, i.e., subject to the provision that the bank would charge its client interest on a minimum amount which is generally about one-half of the maximum limit of the drawing power allowed to the borrower by the bank. Similarly the lending bank can curtail or withdraw the facilities any time." The system is thus advantageous to both sides, and although it is said to have hindered the development of the bill and acceptance market, it is certainly very popular.[1]

Another very common method of raising funds is what is loosely called "two-name borrowing." This takes various forms. Sometimes a promissory note is endorsed by a shroff or shroffs, or by a managing agent or a firm of managing agents; sometimes this signature is needed even in the case of advances made on the hypothecation of stocks; and sometimes it may be just a *hundi* which is in effect a two-name paper. The bulk of the accommodation afforded is, however, based "on the tangible security of valuable assets such as bonds, shares and immovable property, or on the security of merchandise deposited either in the bank's godowns or in the godowns of the borrower under letters of hypothecation."[2]

The principal reason why joint-stock banks in India have insisted on having tangible securities before they would lend out money to merchants and industrialists has been the tradition established by the old

1 *Ibid*, pp. 381-82.

2 *Ibid*, p. 381.

Presidency Banks and later followed by the Imperial Bank of India. This tradition has been re-inforced by the memory of unfortunate banking collapses that have taken place from time to time as a result of somewhat speculative and improvident advances. Another contributory cause has been the provisions of the Indian Companies' Act which require that, for the purposes of the balance sheet, a bank's advances should be classified as secured and unsecured, and shown separately. The result has been that the granting of unsecured loans on properly appraised credit has not been regarded as good banking; on the other hand, share-holders have frowned on such advances as they have been held to lack safety and prudence. Moreover, the absence of touch between borrowers and lenders and the lack of knowledge resulting therefrom, and the Managing Agency system have served to accentuate the practice of demanding tangible securities before a loan is granted.[1]

Somewhat similar to the ordinary commercial joint-stock banks are the loan offices most of which are located in Bengal. They all had originally been started along the lines of land mortgage banking and they all attract funds by receiving deposits. Their paid up capital is small and their working funds meagre compared with those of the joint-stock banks. Their business, however, consists in lending money to zamindars and cultivators: they rarely finance trade or industry.[2] As a consequence of this lending to people who are directly dependent on agricultural prosperity

[1] *Ibid*, pp. 381-82.

[2] Report of the Bengal Provincial Banking Enquiry Committee (Calcutta, 1930), paras 420-463.

for the liquidation of their indebtedness, most of these loan offices have been hard hit by the depression of the last few years and the little importance they had in the money market has been considerably weakened.[1] For purposes of our survey of industrial finance they may, therefore, be conveniently treated along with joint-stock banks proper.

Last but not least, are the bigger indigenous bankers. Here we must make a broad distinction between real bankers and money-lenders pure and simple. Generally speaking, the latter work with their own capital and do not, as a class, receive deposits ; they finance consumption rather than trade, and advance more often without than with security. The indigenous shroffs or bankers, on the other hand, receive deposits from the public and finance industry and trade rather than consumption; and they lend more often with than without security. The distinction is sometimes blurred and there are cases where money-lenders do some banking business and bankers take to forms of pure money-lending. Nevertheless, there is a broad difference between the two classes and the distinction is important from our standpoint in as much as it is the indigenous bankers and not the moneylenders who play a prominent part in the sphere of industrial finance.[2]

The various types of indigenous bankers may now be noted. Broadly speaking, there are three types of these indigenous bankers. First come those who

1 Note by Mr. N. R. Sarkar on "Loan offices in Bengal", Indian Central Banking Enquiry Committee (1931), Majority Report, pp. 201-206.

2 Majority Report, pp. 73-75.

confine their business to banking proper or whose principal business is banking; next may be mentioned those who are principally traders or merchants but who employ their surplus funds in banking business; finally, there are those who are both bankers and traders and cannot be easily classified either as bankers or as traders.[1]

We have seen that these indigenous bankers had a flourishing business all over the country during the early years of British rule in India.[2] Political turmoil and incessant wars, however, severely affected their operations and the unification of coinage in 1835 deprived them of their profitable business of money-changing. The impact of a new economy and changes in the whole basis of India's trade, external as well as internal, only hastened their downfall. The creation of Government treasuries and the establishment of banking institutions on western lines operated to their further disadvantage, and with the decrease in the volume of their business their resources also diminished.[3]

In respect of large-scale operations indigenous bankers are to-day definitely at a disadvantage. But it would be a mistake to suppose that they have ceased to play a part in the Indian money market. They still fill the gap left uncovered by the joint-stock banks and co-operative banks run on western lines and especially in rural areas their help is as indispensable as before. With altered conditions, however, they have in some cases begun to act as middlemen between

[1] *Ibid*, p. 99.

[2] *Supra*, Chapters II and III.

[3] Jain: *op. cit.*, pp. 16-23.

the Imperial Bank and other joint-stock banks on the one hand and the Indian trading community on the other. They buy and sell *hundis* and then rediscount them at the big banks when necessary, and thus perform functions analogous to those of the bill brokers of the London money market.[1]

Any attempt at estimating the nature and extent of the part that indigenous bankers play in providing finance to India's industries and trade is handicapped by the fact that no reliable statistics about them and their operations are available. On the one hand, they possess a great advantage over joint-stock banks in that their operations are not attended with formalities or delays. Their accounts are kept in a simple and economical way and they are easily and always accessible. Their establishments are not costly and they always maintain a close personal touch with the traders and the small industrialists whom they finance. On the other hand, it is difficult to say how far they actually finance enterprises other than those of the cottage industry type. That they play a very prominent part in rural finance and in certain forms of trade is well-known, but it is doubtful if an appreciable number of indigenous bankers take an active and direct part in providing finance to major industrial operations in India. It seems that their influence is definitely declining: they are losing their hold on deposits and the competition of new agencies is reducing their lending rates; they are being outwitted by institutions that can raise any amount of deposits at cheap rates and can

[1] The Bombay Provincial Banking Enquiry Committee Report (Bombay, 1930), para. 252.

freely transfer their loanable funds from one centre to another as desired.[1]

Let us now consider the relations of these various agencies to each other and to the market as a whole. The first thing that strikes any casual observer is the absence of a central co-ordinating agency in the Indian banking system. The foundations of a sound credit organisation cannot be truly laid because neither the joint-stock banks and indigenous bankers nor the Exchange banks are able, when necessary, "to turn into cash a maximum of their assets with a minimum of disturbance to general conditions." There having been no true Central Bank in the Indian credit system, 'the facilities of re-discounting, which only a Central Bank can properly afford, have been almost nil.[2] The Imperial Bank of India has played the rôle of a bankers' bank, but there has been no legal provision compelling the other banks to keep minimum balances with it and the service that it has rendered to other banks by granting loans against the security of Government paper at Bank rate has been largely negatived by the relatively high level of the rate on most occasions. As a matter of fact, owing to the special privileges enjoyed by the Imperial Bank as the Government banker, the other banks have looked upon it more as an unfair rival than as a friendly co-adjutor. On the other hand, some of the joint-stock banks look upon the Exchange banks as formidable rivals on account of their large resources and their ability to attract deposits at more favourable rates of interest than themselves. A feeling has also grown in recent years that co-operative banks are

[1] Indian Central Banking Enquiry Committee (Minority Report), 1931, pp. 100-108.

[2] Report of the Royal Commission on Indian Currency and Finance, 1926 (Cmd. 2687), p. 33.

beginning to compete with the ordinary commercial banks and indigenous bankers in spheres of business which are outside the purview of co-operation proper, e.g., opening accounts, purchasing drafts, selling remittances etc. Further, the Exchange banks have never been under any statutory obligation to keep balances with the Imperial Bank, and if the indigenous bankers have ever kept accounts with the Imperial Bank, it has been only for purposes of remittance or paying bills drawn on them by outside merchants and collected through the Bank. In the busy season, however, when the supply of *hundis* has exceeded the capacity of shroffs, a temporary link has often been established between the Imperial Bank and joint-stock banks on the one hand and selected shroffs on the approved list of these banks on the other: these banks could then afford re-discount facilities to the shroffs subject to certain maximum limits based on the financial standing of the latter.[1]

The fact thus emerges that the Indian banking system has been very loosely organised, and hence the Bank rate in India has had none of the significance and influence which it has in other countries with better organised and developed banking systems. In these latter countries (e.g., England, Germany, France and the U. S. A.) all the various rates that prevail in the market move simultaneously and sympathetically with the Bank rate (which is the rate at which first class trade bills can be discounted at the Central Bank), and, in spite of certain limitations, the Bank rate policy of the Central institution becomes a most delicate but beautiful instrument for the purpose of controlling the

[1] Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 394-95.

currency and credit of those countries.[1] In India, on the other hand, "there has been no fixed relation between the rate paid by banks on deposits and the Imperial Bank rate. The holdings of bills have never been on a large scale, and such bills as have been purchased by banks have been looked upon as a definite investment and there has rarely been any question of re-discounting them."[2]

Even a cursory analysis of the various rates that prevail in the Indian money market at any one time would show that the movement of credit between the various markets inside the system is extremely sluggish. Truly speaking, there is no one money market in India and the Imperial Bank rate, which has been quoted until recently in financial journals along with the Bank rates of the Central Banks of other countries, has simply meante the rate at which the Bank would ordinarily advance money against Government securities. On the other hand, the rate at which the Imperial Bank would discount or

1 The following table would give an idea ot the relations between the various money rates ruling in the London Money market :

	March 5, 1931.	March 12, 1931.	March 19, 1931.	March 26, 1931.
	%	%	%	%
Bank Rate (defined above) ..	3	3	3	3
Banks' Deposit Rate (i.e. the interest that clearing banks pay on time deposits) ...	1	1	1	1
Clearing Banks' rate for money at short notice ...	2	2	2	2
Market Rate (3 months' bills) i.e. the rate at which sound bills are discounted by the market	$2\frac{5}{8}$	$2\frac{5}{8}$	$2\frac{9}{16}$	$2\frac{9}{16}$

Also cf. Report of the Committee on Finance and Industry, Cmd. 3897 (London, 1931), pp. 95-99.

2 Indian Central Banking Enquiry Committee (Majority Report), 1931, p. 397.

re-discount first class bills (of 61 days' date) has been called the Imperial Bank *hundi* rate. And although there has been an intimate connexion between the two rates, their seasonal movements have by no means been simultaneous or proportionate. Then again there have been the inter-bank call money rates and bazaar rates. The former are the rates for day to day loans given by banks and while in other countries such rates tend to move *pari passu* with the Bank rates, in India there has been no such movement at all.[1] "In India we find that call money is sometimes unlendable in the slack season at almost any rate, while it may not be obtainable even at Bank rates in the busy season."[2] The bazaar rates (rates at which the bills of small traders are discounted by shroffs) have been more fantastic still, bearing little relation to the Imperial Bank rate and often varying widely even between two adjacent business centres. There has been practically no link between the bazaar market and the market controlled by banking institutions working on western lines, and hence rates in the former have been more or less established by local custom and have not necessarily risen or fallen with the Bank rates of interest which have been determined with reference to general trade conditions all over the country. Large seasonal fluctuations in the demand for the financing of the staple crops have only added to the looseness of the various prevailing rates. The net result has been that the Bank rate in India has been a very poor index of the general trend of the rate for investment money and hence no more important than the various other rates that have prevailed in the money market.[3]

1 See Appendix VII.

2 *Ibid*, pp. 397-402.

3 Report of the Controller of the Currency for 1928-29 (Calcutta, 1929), p. 12.

Another grave defect in the organisation of the Indian money market is the fact that the central money market has been to a large extent dominated by Government which has controlled the currency and exercised a decisive influence on the Bank rate.[1] Not that there is anything inherently pernicious in Government interfering in the credit mechanism of the country: but, as was well pointed out by the Commission of 1926, the system in which control of currency and credit is in the hands of two distinct authorities (viz., Government and the Imperial Bank of India) whose policies may be widely divergent, is inherently weak. The system has resulted in a serious lack of elasticity and stability of monetary conditions.[2]

This brings us to the credit operations of the Government of India and their repurcussions upon the money market. In addition to floating annual loans mainly for its capital expenditure, Government is continually in the market for short-term funds through the medium of treasury bills. Both these operations have had important effects on the credit system of the country. When Government is the greatest borrower at a tempting rate of interest it is but natural that the few who could invest would not invest in banks or in industrial concerns. The masses are extremely conservative and nearly all of them prefer a slow but safe present rate interest to an uncertain higher and future rate of interest.[3] The issue of treasury bills, in pursuance of exchange and currency policies have often

[1] Memorandum of Dr. L. J. A. Trip: Indian Central Banking Enquiry Committee Report, Vol. IV, 1931, p. 358.

[2] Report of the Royal Commission on Indian Currency and Finance, 1926 (Cmd. 2687), p. 33.

[3] Wadia and Joshi: *op. cit.* pp. 401-02.

resulted in a temporary contraction of credit:)this has happened particularly when the proceeds of treasury bills have been utilised to contract currency by cancelling *ad hoc* securities.[1] All this has undoubtedly reacted on all investments. How far this reaction has caused a perpetual disturbance in the money market is a matter of controversy, but there is no doubt that the absence of a central co-ordinating agency has prevented Government from working in close co-operation with the credit system of the country in respect of their borrowing operations.

(A third important defect in the credit situation of the country is that no well-developed and expansive bill market exists in India.) Now, a typical commercial bill is created in this way : a manufacturer, say a cotton mill, sells goods on three months' credit to a wholesale dealer and, as a preliminary condition of the credit, the dealer accepts a draft drawn on him by the mill. Such a bill is self-liquidating in as much as it arises out of a *bona fide* sale and has got the backing of goods sold behind it. When the manufacturer is in need of cash he approaches his bank with a request to discount his bill. If the manufacturer is of good standing and if the acceptor of the bill is also known to be sound, the bank will gladly discount such a bill, especially when he knows that the Central Bank is willing in its turn to re-discount the bill.[2] The difficulty in India has been, however, two-fold. First, the major part of Indian production and business consists of agricultural produce and there is not

1 When the proceeds of the treasury bills are disbursed into the money market, the contraction is counterbalanced and the net result of the operations may be said to have caused dearer money without creating a scarcity of money.

2 The bank discounts the bill by deducting the interest for the period in question and crediting the balance to the manufacturer.

the same chance to create bills there. "When crops are marketed they are sent on their way to the consumer by small merchants through large ones and it is evident that in practice such small merchants are not in a position to grant credit to the large ones. On the contrary, it is the bigger merchants who often advance money to the smaller traders to buy agricultural produce for themselves."[1] Secondly, even where commercial bills can be created, the fact that the re-discouting of such bills with the Imperial Bank of India is regarded as a sign of weakness has made banks unwilling to hold a large part of their assets in bills.[2] The system of cash credits in vogue in India with certain incidental advantages both to the lender and to the borrower also stands in the way of a greater

1 S. Bhatter and L. Nemenyi: The Reserve Bank of India and its functions (Calcutta, 1933), pp. 110-19.

2 The following figures (1928) of the London Clearing banks, the Imperial Bank of India and six Indian joint-stock banks (Allahabad Bank, Bank of Baroda, Central Bank of India, Bank of India, Peoples' Bank of Northern India and the Punjab National Bank) showing the distribution of their assets give some idea of the difference:

	London Clearing Banks. Millions of £.	Imperial Bank of India Lakhs of Rs.	Six Indian joint-stock Banks Lakhs of Rs.
Cheques in Transit ...	48	...	...
Investment ...	259	19,04	20,66
*Bills discounted ...	246	12,47	1,23
Advances to customers ...	945	51,85	33,42
Money at call and short notice ...	145	...	...
Cash	197	10,65	6,83

**N.B.* Banks in India do not often show investments in bills separately and in many cases the figure is included in the total figure of advances. The very small figure under the heading of bills must, therefore, not be taken as strictly correct, though it may be assumed that the reason for not showing it separately in certain cases is that it is too small to be treated as an independent item.

use of bills. The result is that both the manufacturer and the trader in India have to work without a very effective and useful instrument of obtaining credit from banks.

Thus we see that although India possesses many of the external appendages of an elaborate credit mechanism, she does not yet possess a "system" that would make regulation and control of credit possible. Banks are marked off into different types, each doing a definite and distinct kind of business : (there is too much decentralisation and specialisation, and too little co-ordination.) Moreover, the independent loan operations of Government often create a feeling of nervousness among investors who feel a kind of hesitation to take up industrial securities.[1] The limited bill and money market and the particular kind of merchandise serving as security in a country of agricultural production and export render the Indian joint-stock banks less fit to take an active part in industrial finance, and it is, therefore, no wonder that the balance sheets of Indian banks show large amounts invested in Government securities and among their loans a prominent position is held by those given against actual merchandise deposited in the banks' godowns or hypothecated in the proper legal form with the customer.[2]

1 Written Evidence of the Allahabad Bank Ltd before the Indian central Banking Enquiry Committee: Report, Vol. II, p. 6.

2 Memorandum by Dr. O. Jeidels: The Indian Central Banking Enquiry Committee, Report, Vol. IV. pp. 1-2.

CHAPTER IX

The Financial Requirements of India's Industries and How They Are Met.

When industries in India were grouped in small villages and towns and in small establishments, and when they catered for limited markets the problem of financing them was very simple. Capitalist economy and large-scale production, however, brought in its train the formidable problem of finding finance for them : competition on a large-scale, which is the keynote of modern capitalist organisation, demanded that an enterprise, in order to be able to hold its own, must be able to find the necessary money and brains smoothly, regularly and easily.

"Broadly speaking, industries require capital for two purposes—(1) capital for block, that is, to finance fixed assets and (2) working capital, that is, to finance floating assets. Block capital is required by newly started industries for fixed assets, such as land, buildings, machinery and other appliances of a durable and permanent character. It is also required in the case of established industries for purposes of extensions and replacements. Working capital is required for the purchase and working up of raw materials into finished products, for stores, for expenses incidental to the marketing of products, for financing outstanding operations in respect of goods supplied, and for providing the necessary funds for meeting day-to-day requirements. The capital that is invested in this latter way is of the

nature partly of permanent or long-term capital and partly of short-term finance."[1]

The relative proportion between block and working capital required in an enterprise varies from industry to industry. As the process of production becomes more and more roundabout or capitalistic, the proportion of fixed to working capital needed increases. In most of the modern industries, especially in such major industries as cotton, jute, steel, mining etc., the financing of the large requirements of fixed capital is a formidable problem.

So far most of the major industries in India have obtained their capital for financing fixed assets either by public or private subscription of shares or debentures of the undertaking, or by direct deposits, or by the system of providing money on private account by an individual or a partnership. The part played by these diverse methods has of course varied from industry to industry and the recent tendency has been towards securing the block capital by public or private subscription of shares or debentures. In the cotton textile industry, for instance, apart from the few older establishments which still retain their private proprietary character, the fixed capital has been found mostly from paid up share capital, though in some cases this has been supplemented by debentures. Except a very few mills which have a portion of their capital in preference shares, the share capital consists entirely of ordinary shares of face values varying from Rs. 25 to Rs. 1,000 per share. There has been a commendable tendency in recent years to split up shares of large face values into shares of

[1] The Indian Central Banking Enquiry Committee (Majority Report), 1931. pp. 267-268.

smaller denominations with a view to bringing them within the easy reach of smaller investors. In some cases extension of the fixed plant and machinery was wisely provided out of issue of preference shares at a time when the companies concerned had established a sound reputation by their unbroken record of dividend payments. Sometimes debentures are issued for limited periods on the security of the fixed assets consisting of land, buildings, plant and machinery for the same purpose of extension or introduction of new devices. "The amount for which debentures are issued by any mill is determined by a conservative valuation of its fixed assets and also by the state of the industry at the time of issue. Generally speaking, most of the debentures issued are held by some of the native Princes and are not freely marketable."[1]

In the iron and steel industry, too, share capital (including preference shares, and ordinary and deferred shares) has provided nearly all the money needed for financing the fixed assets, and the experience of the hydro-electric industry has also been the same.[2] On the other hand, (cases are not rare where even fixed assets are financed by direct deposits from the public: this obtains particularly in the cotton mill industry of Ahmedabad.)

Lastly comes the method of providing money on private account by an individual or a firm or a partnership: this was much in vogue in India when the joint-stock principle was not properly appreciated, and many of the plantation enterprises like tea, coffee and sugar and

[1] Written Evidence of Mr. A. D. Shroff before the Indian Central Banking Enquiry Committee: Report, 1931, Vol. II, pp. 986-87.

[2] *Ibid*, pp. 387-91.

some of the mining enterprises have, in the past, been launched in this manner. Even now-a-days many small ventures are started with assets financed by money secured on private account by an individual or a firm or a partnership. Many of the rice mills, oil mills, hosieries, soap factories etc., are run on an individual proprietary basis, the owner bringing his own capital for meeting the initial outlay such as is necessary for acquiring land, setting up the factory, purchasing machinery and raw materials and providing other equipments.[1]

As regards the working capital, this is obtained either from private deposits, or from money on private account provided by the entrepreneurs and their friends, or from loans given by the commercial banks and indigenous bankers. In the cotton textile industry the working capital is obtained from two sources—(1) deposits; (2) banks loans and cash credits. "With very few exceptions cotton mill companies generally depend for their working capital to a considerable extent on deposits received from the public. These deposits are in most cases from six to twelve months and the rates vary with the credit of the individual mills and of their Managing Agents.........Public confidence, till very recently, was so well established that good mills were able to obtain deposits not only at the same rates as quoted by banks but in some cases even $\frac{1}{2}\%$ cheaper than banks."[2] Besides these deposits from the public most of the mills in Bombay and up-country centres have certain arrangements with their banks by which they obtain loans on the security of stocks of

1 Written Evidence of the Bengal National Chamber of Commerce, *ibid*, p. 484.

2 Written Evidence of Mr. A. D. Shroff: *ibid*, p. 387.

cotton and cloth, both manufactured or in process of manufacture. "In some cases loans are raised on gilt-edged securities deposited with banks; in others, only on the promissory notes of the company with a copy of the resolution passed by the Board of Directors." In most of these cases, however, banks insist on the additional guarantee of the Managing Agents over and above the stocks hypothecated to them. As a rule these advances are secured for twelve months and are renewable thereafter; the rate of interest charged varies with changes in the Imperial Bank rate with a fixed minimum in certain cases.[1]

In the iron and steel industry where the requirements of working capital are very large the problem of finding finance has always been acute. The Tata Iron and Steel Company had once to seek Government assistance for working its plant and this took the form of "a fixed loan of Rs. 50 lakhs by the Secretary of State for India with whom the Company deposited an equivalent amount of its unissued debentures."[2] Cash credits have often been obtained from the Imperial Bank of India against hypothecation of a part of the Company's stock-in-trade. These facilities have from time to time been suplemented by large amounts of unsecured loans or one-year deposits which the Company has been able to raise on its own promissory notes. In the hydro-electric industry, too, finance for floating capital has been obtained by such methods, but here some Princes have made substantial contributions not merely in respect of floating, but in respect of fixed, capital as well.

1 *Ibid*, p. 388.
2 *Ibid*, p. 389.

In the sugar industry again most of the working capital has generally been found from banks and the various firms of Managing Agents which control the companies. The rate of interest charged by banks has generally been 1 to 2% over and above the Imperial Bank rate with a certain minimum (usually 6%). Some companies have been lucky enough to borrow direct from the Imperial Bank at Bank rates ; on the other hand some of the private proprietary companies have obtained their working finance from private resources, not excluding munificent advances given by some of the Indian Princes.[1]

The jute mill industry has had a comparatively easy time so far as the problem of finance is concerned. Having invariably started with large capital, jute mills in India have always had easy recourse to the banks for temporary accommodation, and have experienced little difficulty in obtaining their working funds. The reputation and standing of their Managing Agents have also been valuable assets in securing the requisite finance.[2]

On the other hand, many of the newer enterprises and smaller concerns have had to contend against heavy odds in securing the necessary working capital for themselves. It is not an exaggeration at all to say that most of the industries that have not had the advantage of an early and favourable start, have to experience great difficulties about finance in India. The Indian Steel Wire Products Ltd., for instance, could not increase its output

1 Written Evidence recorded during the Indian Tariff Board Enquiry on the Sugar Industry (Calcutta, 1931), Vol. I.

2 Written Evidence of the Bengal National Chamber of Commerce before the Indian Central Banking Enquiry Committee: Report, Vol. II p. 486.

during the cold weather of 1923-24 mainly due to a shortage of working capital and the difficulty had eventually to be removed by the Government of Bihar and Orissa sanctioning in August 1924 the Bihar and Orissa State Aid to Industries Act.[1] Even the sound concern of Tata Iron and Steel Company had to face very serious financial difficulties for a number of years after the War. And in the paper and paper pulp industry the financial difficulties of the chief concerns could be solved only by a Government guarantee of a public issue of debentures.[2] In the plywood and tea chest industry, too, money has been obtained with considerable difficulty: an ordinary manufacturer has hardly been able to borrow money over an extended period at a rate within 1 per cent of the Imperial Bank rate.[3]

As a matter of fact, (loans have often to be dearly paid for whether they are obtained from indigenous bankers, joint-stock banks or as deposits from the public.) In the tea-gardens belonging to individual proprietors, for instance, loans are obtained from Marwaris and other indigenous bankers only at rates varying from 12 to 20 % (according to the credit position of the borrower) and even then the personal security of the proprietor has sometimes to be coupled with a mortgage of the garden property. Loans obtained from loan offices are secured at somewhat lower charges, but there, too, the personal guarantee of some directors and the mortgage of the gardens as collateral security are considered essential.

1 Report of the Indian Tariff Board regarding grant of Protection to Wire and Wire nail Industry (Calcutta, 1926), p. 5.

2 Report of the Indian Tariff Board regarding grant of Protection to the Paper and Paper pulp Industry (Calcutta, 1925), pp. 86-87.

3 Report of the Indian Tariff Board regarding grant of Protection to the Plywood and Tea Chest Industry (Calcutta, 1927), pp. 25-26.

Sometimes Managing Agents provide for the finance as well as sale of crops of some of these tea-gardens, but that only means that the enterprises so financed lose all their independence and initiative in the matter of production, sale and marketing. Particularly (unfortunate is the lot of those concerns which, being newly started, cannot approach either the selling brokers or the loan offices with their limited assets and hence have to borrow at very high rates of interest from indigenous bankers who not only cover their loans by the double security of mortgage and personal guarantee but also insist occasionally on a fairly large commission on future sales.[1]

Nor should it be imagined that industries that are owned and managed by joint-stock companies fare better by virtue of their corporate organisation. "The realisations from their share floatations do not enable them to meet all capital requirements and their dependence on outside finance is no less marked than in the case of similar establishments owned by individual proprietors. (Loans are available to the companies only when some directors agree to pledge their personal guarantee as cover in cases where no collateral mortgage of some real property is demanded by the financing agent.) And when such loans are obtained from indigenous bankers they charge the same rate and stipulate the same conditions as are demanded from and imposed on the borrowing individual proprietor."[2])

(Any account of the financial assets and liabilities of Indian industries will be incomplete without a description

[1] Written Evidence of the Bengal National Chamber of Commerce before the Indian Central Banking Enquiry Committee: Report, Vol. II, pp. 483-84.

[2] *Ibid*, pp. 483-85.

of an organisation that has been extolled, on the one hand, as a masterpiece of human ingenuity by its admirers, and condemned, on the other, as an instrument of knavery and fraud by its critics. This is what is popularly called the Managing Agency system. This consists in the arrangement that most of the trading firms do not specialise, but deal in a large variety of goods, and that they undertake the actual management of most of the plantations and other industrial enterprises capitalised and controlled either by individuals and partnerships or by joint-stock associations. The system arose out of the peculiar circumstances of India during the years before the Mutiny when the difficulty of maintaining a continuity of policy and efficient direction and management drove most of the enterprises, whether private or corporate, to hand over the actual management of projects to old well-established firms which were doing trade in the country. These firms came to undertake the "management" of one thing after another on a commission basis and were called the Managing Agents of the various companies for whom they acted. Sometimes the Managing Agency system arose in another way: when a private merchant wanted to retian some interest in his business even after his retirement, he would form a joint-stock company and hand over the actual management to a well-known firm of Managing Agents.[1]

Although the functions of the Managing Agents vary greatly from industry to industry and their position varies from that of secretaries to that of managers or directors, in practice they direct the directors, administer all affairs of the companies they manage and in some

[1] **Anstey**: *op. cit.*, p. 113.

cases they have been actually known to take power in the Articles of Association to dispense with the directors altogether.) These Articles of Association are very important: they are drawn up when a company passes under the management of Agents and they define carefully the powers and duties of the "Secretaries and Agents" of the new company. As a rule an annual sum is paid to these Agents for office and other expenses and a commission is paid on their output, sale or net profits.[1] And the incidental profits which they make from the ability to manipulate the finance of the various companies under management are very great indeed.[2]

The system has several advantages. It promotes efficiency by concentrating power in the hands of a really small number of business magnates. It conduces to cautious finance and watchful interest. It ensures a superior unitary and autocratic control which is not otherwise possible in the peculiar business circumstances of India where local boards of directors are reputed to interfere unduly in the actual management of an enterprise. The companies also gain a certain amount from the goodwill of the Managing Agents' firm and have their resources to fall back upon in a crisis. And specially in certain industries (Managing Agents have rendered yeomen's service for the concerns they manage) Thus in Bombay when an industrial concern is started, particularly a cotton mill, it is the Managing Agents who attract the capital from their friends and others who are aware of their standing. The working capital is found from private deposits and from loans and cash credits from banks, and in both cases the amount and frequency

1 *Ibid*, Appendix E.

2 The Round Table (London), March, 1923.

depend largely on the standing of the Managing Agents. Sometimes the Managing Agents themselves provide finance on consideration of being appointed agents for buying raw materials and selling or distributing the products of the industry concerned. In Calcutta, too, among the jute mills and tea gardens, it is the Managing Agents who arrange the finance, both block and working, either by raising share capital or arranging with banks or other financiers, or supplying it themselves. Finally, in Ahmedabad, where the system is said to have had an unqualified success, most of the block capital of the cotton mills is obtained from deposits and from funds supplied by the Managing Agents themselves. Even as regards working capital the Ahmedabad mills obtain little assistance from banks: the same agencies that provide the major part of block capital provide the floating capital, too. And the rate which the Managing Agents charge to the mills for the money they advance is said to be never more than 6 per cent, and compares very favourably with the rates of interest on deposits.[1]

That the system has quickened the industrial development of India in the past is beyond question. At a time when the number of Indian entrepreneurs of the requisite calibre was very limited and in any case Indians did not command the confidence of European investors while European managers did not remain at the work long enough to secure continuity of management, it was the Managing Agency system that supplied an efficient and continuous direction of business policy. It has certainly filled an important need in the Indian industrial economy. Banking as known in the west is practically unknown even to this day in some parts of the country and it is certain

[1] Report of the Indian Central Banking Enquiry Committee (Majority Report), pp. 275-80.

that in many cases without the backing of a wealthy and influential house of Managing Agents it would have been almost impossible to raise any large amount of capital and equally impossible to finance its floating assets. "Mills in India are dependent largely on the standing of the Managing Agents for the funds they require much more than in other countries which are more advanced in banking matters, for, whereas in the latter supplies of cotton or stores are covered by bills of exchange at 60 to 90 days' sight and the mill is, therefore, able to keep control over a large supply of the necessary cotton etc. for its near future requirements without having to lock up capital, an Indian mill has immediately to provide the cash necessary for its purchases."[1] In the loosely organised and imperfectly developed money market (or markets) of India, the Managing Agents have been a really useful and co-ordinating force and have considerably smoothened the economic and industrial development of the country.[2]

In spite of its obvious services to the economic development of India, the system seems to have outlived its usefulness. It has given special opportunities for exploitation and even fraud. In many cases the power of Managing Agents has tended to increase with the passage of time, and often a firm that started only with managing a company has ended by selling raw materials to it, contracting for its stores, distributing its products and even effecting its insurances. With a multitude of interests to look after, Managing Agencies have been naturally conservative and reluctant to embark on new ventures :

[1] Report of the Indian Tariff Board (Cotton Textile Industry Enquiry, Calcutta, 1927), Vol I, pp. 91-92.

[2] Evidence of Mr. B. F. Madon before the I. T. Board (Cotton Textile Industry Enquiry, 1927), Vol. IV of Evidence and Memoranda.

they have tended to favour commercial rather than industrial enterprises, to the detriment of the economic development of India as a whole.[1] Owing to multiplicity of interests and the location of their offices at great distances from the concerns they look after, Managing Agencies have never been able to be in as close a touch with companies as is desirable. And in Ahmedabad, where the system is said to have worked with the greatest ease and perfection, the tendency for the Agencies to pass from father to son or to some other relative and to be regarded somewhat in the light of a family possession has certainly been impairing efficiency of management.[2]

The system prevents to-day the growth of sound joint-stock associations. The interests of shareholders always come second to those of Managing Agents and as the latter always absorb too large a share of the profits, industry as a whole appears less attractive to the average investor. "It, therefore, tends, not to encourage, but to check the flow of capital to industry. Ancilliary activities of Managing Agents, who are known to speculate on the stock exchanges in the shares of their own concerns, also lead to the same result." Again, "the Managing Agents' commissions (contracts) have been the subject matter of sale and transfer without any reference to the shareholders and without any idea of its consequences on industry. When Managing Agents speculate and lose money, the credit of the concern under them is reduced or destroyed. The shareholders, who have purchased shares on the basis of the personal reputation, efficiency and competence of some

1 Report of the Indian Tariff Board (Cotton Textile Industry Enquiry, 1927), Vol. I, p. 88.

2 Anstey: *op. cit.*, p. 115.

partners in the Managing Agents' firm, may find themselves, without any notice, faced with control by new parties, who may be young, or incompetent, or completely unfit to carry on the work."[1])

(Even in the sphere of finance, the services rendered by Managing Agents have not been as perfect as they are made out to be.) Apart from the fact that such advances as are made are never disinterested, it is notorious that such facilities as the ordinary joint-stock banks are generally prepared to offer to industries are not utilised by them, as many Managing Agents are unwilling to avail themselves of them on the ground that this involves visible control by the banks which would lower their standing in the eyes of their creditors and the investing public and thus increase the difficulty of obtaining fixed deposits.[2] Moreover, although it is true that in times of crisis Managing Agents have incurred extensive losses as a direct result of financing the mills under their control, there have been a few cases in which these Agents have turned their loans to mills into debentures, with the result that the concerns have passed into their hands and the shareholders have lost all their capital invested in the undertaking. The system of Managing Agency finance works well when everything goes on smoothly and when industries are prosperous, but in times of depression when Managing Agents are compelled to find more money to support them, it often happens that most of them are unable to cope with the situation.[3]

1 Indian Central Banking Enquiry Committee (Minority Report), 1931, pp. 330-32.

2 Report of the Indian Tariff Board (Cotton Textile Industry Enquiry, 1927), Vol. I, p. 92.

3 Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 279-80,

The question of finance by the Managing Agents brings us to another system—the system of direct deposits that prevails in the cotton textile industry of Bombay and Ahmedabad. The system arose owing to the imperfect banking development of the country: on the one hand, people naturally had more trust in, and preferred to confide their savings to, those men in their communities whom they knew and with whom they could deal without the formalities necessary in dealing with banks; on the other, millowners were ready to accord to depositors a safe return with certain net advantages which the latter could not possibly get either from banks run on western lines or from indigenous shroffs.[1] So arose an arrangement whereby the cotton mills of Bombay and Ahmedabad got most of their working capital from the public on short-term deposits, usually for six months or a year. The importance of this system to the cotton textile industry of these two cities is illustrated by the following figures:[2]

	Bombay (Figures for 64 mills)		Ahmedabad (Figures for 56 mills)	
	Lakhs of Rupees.	Percentage of total finance.	Lakhs of Rupees	Percentage of total finance.
1. Amount loaned by the Managing Agents	5,32	21	2,64	24
2. Amount loaned by banks ...	2,26	9	42	4
3. Amount of public deposits ...	2,73	11	4,62	39
4. Amount of share capital ...	12,14	49	3,40	32
5. Amount of debentures issued ...	2,38	10	8	1

[1] Evidence of Mr. B. F. Madon before the Indian Tariff Board (Cotton Textile Industry Enquiry, 1927), Vol. IV of Evidence and Memoranda.

[2] Indian Central Banking Enquiry Committee (Minority Report), 1931, pp. 329-30.

This system of direct deposits is on the decline in Bombay, but it still flourishes with vigour in Ahmedabad. Its contribution to the progress of the cotton textile industry in the Bombay Presidency has undoubtedly been very great, but the recent depression in the industry has served to expose all its weaknesses. In times of stringency mills whose financial position is not strong, find great difficulty in obtaining deposits, although it is these mills which need help: the tendency of depositors to withdraw their advances on the slightest rumours of difficult times puts the mills in a most unenviable position.[1] Nor can the depositors be blamed for doing so. They cannot follow the movements of the money market and understand what is happening; they remain in the position of unsecured creditors and as there is no intervening banking institution with its superior equipment between themselves and their lenders, they are apt to be easily led away by any bazaar gossip regarding the solvency or otherwise of a concern. Now, the only thing that a concern beset with such a sudden demand for withdrawal of deposits can do is to raise a loan elsewhere, and in a time of depression such an alternative is hardly feasible. The system of direct deposits is thus a source of great danger to an individual industrial enterprise and in spite of the services it has rendered in the past its utility should be regarded with genuine misgivings these days.[2]

Let us now analyse what views industrialists hold about the financial facilities they enjoy. The most marked divergence of views appeared in the replies to the question whether existing facilities were adequate when the Indian

[1] Evidence of the Bombay Millowners' Association before the Indian Tariff Board (Cotton Textile Industry Enquiry, 1927), Vol. II, p. 209.

[2] Indian Central Banking Enquiry Committee (Minority Report), 1931, p. 330.

Central Banking Enquiry Committee was holding its sitting. While representatives of European Chambers of Commerce inclined to the view that financial facilities were more or less commensurate with the economic development of the country, most of the Indian entrepreneurs complained that apart from the Managing Agents and direct depositors, financial accommodation has always been difficult to obtain in India. It was regretted that banks in India did not provide finance for block capital for industries and that conservatism and timidity prevented them from embarking on underwriting of industrial capital or at least of lending money on the security of industrial shares to any great extent. Another cause of complaint has been that banks usually insist on a full backing of tangible and easily realisable security for the loans and seem to take no account of the personal credit and integrity of borrowers. On the other hand, banks have been greatly handicapped by the fact that very often they have not possessed the technical equipment needed to assess the assets and solvency of a concern and the smaller and newer enterprises, too, have, on their part, been unable to supply to banks detailed statements regarding their financial position.[1] Furthermore, trade demands have generally acted to the disadvantage of industry, having taken the lion's share out of a limited available surplus, and sharp fluctuations in the interest rates owing to seasonal variations in trade have also handicapped industrial development. The problem to-day is not merely that industry feels that it is not receiving adequate finance; it is also that available finance can be obtained only at a high price.[2]

1 *Ibid* (Majority Report), pp. 269-73.

2 *Ibid* (Minority Report), pp. 324-28.

CHAPTER X

The Financial Requirements of Rural and Cottage Industries

So long we have considered the problem of industrial finance from the standpoint of the bigger and better organised enterprises alone, but these form but a part of the picture of industrial India. It is, of course, difficult to define "organised industries", but taking the definition in the Census Report as a rough guide,[1] we may say that, in 1921, of the 10. 5 per cent of the population dependent upon industry, the bulk was supported by "unorganised" industries and only 4 per cent by "organised" industries. That clearly shows that the question of financing these "unorganised" industries cannot be dismissed lightly.

Under the category of "unorganised industries" fall such diverse occupations and enterprises as village handicrafts, rural and artistic industries, the work of artisans generally and small scale establishments in towns catering for special limited markets. Some of these give subsidiary occupations to the agriculturists while others provide the principal, and sometimes only, means of subsistence for certain classes. In all these enterprises the requirements of capital are comparatively small, but that does not mean that capital plays an insignificant part.

1 The term "organised industries" denotes "industries in which the establishments include twenty or more employees." (Indian Census Report, 1921, Vol. I, p. 266).

Any consideration of financing these crafts and industries brings us face to face with the fundamental question as to how far these smaller enterprises are economically sound and whether they can really stand in competition with organised factory industries. Here we must beware of making rash and sweeping statements. The term "small industries" is so comprehensive in range that no categorical answer one way or the other is possible.

Certain facts are, however, clear. "In spite of the opening up of India by railways, the competition of cheap imported manufactures and the introduction of a money economy, the old village unit still retains something of its traditional self sufficiency, except in the immediate neighbourhood of large railway or urban centres."[1] These units still have their own local artisans who live by dealing direct with the consumers of their products. The rise of a new class of consumers with the advent of machine-made products from the west and the disappearance of native courts have, however, led to a great increase in the number and power of middlemen and hence a loss of direct contact between the artisan and the consumer. The artisans and independent craftsmen of an earlier era have gradually come to be in the clutches of village money-lenders and many of them have been reduced to the status of industrial wage-earners. In spite of all this, however, the small artisan still holds his own for reasons that are explainable only in terms of hedonistic calculus, and although some observers think that this is a struggle in which the odds are grimly against the small artisan, it would be too rash to conclude that he is going to be ousted from the field in course

[1] Anstey: *op. cit.*, pp. 103-04.

of a few decades. The fact is that in spite of their decline, cottage industries in the different provinces still employ a large population. In Bihar and Orissa no less than $2\frac{1}{2}$ million people are supported by these industries. In Bombay 300,000 people are employed in the handloom industry alone; and 13,000 people are employed in the gold thread industry in Surat. The hand loom industry in the Punjab supports 192,000 weavers.[1]

People engaged in these crafts and industries require capital for three main purposes: they have to get the raw materials, they have to provide themselves with means of subsistence during the period they are engaged in production, and, finally, they have to market their products. Now, artisans and workers engaged in the rural and cottage industries often work to order and not for stock, having received the necessary raw material in advance. This is due to a variety of reasons the most important of which are lack of capital and indebtedness of the artisans, lack of organisation among them, and marketing difficulties. On the other hand, there are independent artisans who do not work to order and receive the raw material or money to purchase it at a high price on credit on condition that the manufactured goods are sold through the lender. Even those who work with their own capital have to sell their products through the local *dalal* or broker to the merchant, and, if they sell direct, they often find that purchasers insist on credit for a month or two during which time they (the artisans) have to find accommodation from the *sowcar* or money-lender at heavy rates of interest.[2]

1 Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 240-41.

2 *Ibid*, pp. 241-47.

This system of working on raw materials supplied by dealers on credit and selling the finished products to those dealers is generally to the detriment of the artisan, as he has to pay a higher price for the raw materials supplied on credit in addition to interest on their value, and is allowed lower prices on manufactured goods. Moreover, as artisans are all scattered and unorganised, they have to put up with any rates that their lenders, who are comparatively better organised, are pleased to charge.

Let us now analyse the financial requirements of the rural and cottage industries more closely. We have seen that capital is needed for three main purposes—for the purchase of raw materials, to meet working expenses during the period of production and to accommodate the artisan between the period of production and the final disposal by sale in the up-country markets. So long these requirements have been supplied by the following agencies, viz., the urban and rural money-lender, the merchant or dealer in raw materials or produce of an industry, the co-operative banks and producers' societies, the Imperial Bank of India and the joint-stock banks, and Government through the Department of Industries and the Co-operative Department. We shall examine the services rendered by each of these agencies one by one.

The money-lender has been, and continues to be the most important figure in the matter of giving financial accommodation to rural and cottage industries. As he is often both the supplier of raw materials and the immediate consumer of finished goods, artisans and small industrialists have had no chance of earning or saving anything wherewith to begin to repay the debt in which they are steeped. The money-lender is usually accommodating, but as generally he alone keeps accounts, if

any, and manipulates repayments in questionable ways, indebtendness has tended to become a permanent condition with artisans.[1] His methods of business and system of accounts vary from province to province with the indiosyncarcies of the lender, the circumstances of the borrower, the nature of the security and the locality. But certain glaringly iniquitous practices are common to the profession as a whole. Loans given without a document and without witnesses, prodigious rates of interest with frequent provisions for compound interest, general apathy as regards the purpose for which a loan is taken, demand for advance interest, general manipulation of the account to the disadvantage of the illiterate borrower—to name only a few—characterise the business methods of the average money-lender in India.[2] If the artisans are part-time agriculturists owning land, it is not difficult to raise money on its security at the usual rate, but when this credit resource is lacking, they have to borrow from money-lenders at exorbitant rates of interest who would also insist on supplying them with raw materials and buying up their finished products. The position is far from satisfactory, but proximity and absence of formalities in the matter of granting accommodation strengthen the position of the money-lender *vis-a-vis* other credit agencies.[3]

1 Indian Co-operative Studies edited by R. B Ewbank (1920), pp. 34-35.

2 Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 74-81.

3 *Ibid*, p. 250. "The worker in the Punjab pays interest varying from 12½ to 37½ per cent. The master workmen in the brass industry in Madras buy their sheets on credit from traders paying 12 per cent interest. Artisans in this industry in the Central Provinces have to pay money-lenders interest at 9 to 15 per cent per annum. In the case of the bell metal industry the firms who supply raw materials charge interest at 7½ to 12 per cent per annum. Weavers in the silk industry at Bhagalpur pay 12½ per cent on loans against ornaments and higher rates on loans on personal security. The chettiyar's rate of interest to people engaged in the cheroot industry in Burma is 1½ to 2 per cent per mensem. In Bombay bigger artisans pay 3 to 4½ per cent on deposits from the public; smaller merchants pay 6 to 9 per cent on loans from indigenous bankers and bigger merchants."

The next financial agency is the merchant or dealer in the raw-materials or produce of an industry. He stands more or less in the same category as the urban and rural money-lender. Although his rates are not generally as a high as those of the typical money-lender, he secures a number of unfair bargains as a middleman, and his lending operations are indistinguishable from those of the money-lender who combines the work of marketing products and supplying materials with money-lending business pure and simple.

Of steadily growing importance are, however, the co-operative banks and producers' societies.[1] Although the first Co-operative Credit Societies' Act was passed in 1904, it was not until 1912 that the formation of societies other than primary societies was authorised. In that year a new Act was passed expressly recognising the extension of co-operative activity to more complex spheres. The preponderating element in co-operation in India, however, still remains credit and agricultural credit. This is because credit is the simplest example of co-operative endeavour that can be introduced among a rural population which is largely illiterate and also because the problem of agricultural indebtedness continues to be the most insistent problem to be solved.

Non-agricultural credit societies are the institutions which finance the artisan and the small industrialist. As, however, they take part in financing other people as well, it is difficult to ascertain to what extent rural and cottage industries alone are benefited by them. Definite data are lacking, but it seems that the credit operations of most of these latter societies are confined to rescuing

[1] See Appendix XI and XII.

the factory-workers from the money-lender into whose clutches most of them fall immediately on taking up residence in a city.[1] Moreover, in spite of the progress and expansion of non-agricultural credit societies during the last few years it is undeniable that they have touched only a fringe of that rural and urban population which needs financial accommodation in respect of their small ventures.[2]

In recent years Government has, in many of the provinces, come down to the assistance of the small industrialist. State aid has been given in a variety of ways including direct money grants, loans, special facilities for obtaining land etc. In Madras the State Aid to Industries Act of 1923 has regulated the giving of grants for such purposes, and similar Acts have since been passed in the Punjab, Bihar and Orissa, the Central Provinces and Berar, Bombay, Bengal, the United Provinces and Burma. How far these various Acts have ameliorated the position of the small industrialist it is too early to judge, but from the evidence that was tendered before the Indian Central Banking Enquiry Committee and the various Provincial Banking Enquiry Committees it seems that the small industrialist still finds himself handicapped for want of adequate finance. As a matter of fact it is a common complaint in many of the provinces that the rules regarding the grant of assistance under these Acts are far too rigid and exacting to be of any practical help to the small industrialist. The fact is that Government is not the proper agency to indulge in the actual financing of business operations and its aid can at best be indirect.

1 Anstey: *op. cit.*, p. 196.

2 Indian Central Banking Enquiry Committee Report, Vol. IV (Calcutta, 1932), p. 721.

Such indirect aid is given by hire-purchase system through co-operative societies, through the provision of technical assistance, through marketing facilities and so forth.[1]

Commercial banks conducted on European lines cannot afford to help the small industrialist as the business of the latter is almost always enveloped in an atmosphere of uncertainty and doubtful efficiency. Joint-stock banks do banking business with an entirely different clientele and the heavily involved small artisan with his paltry resources can hardly fit in there.[2]

Thus the position of the small industrialist is also by no means a happy one. The great problem is that of ascertaining the soundness of a concern asking for financial aid, and this can be best performed by a banker or some non-official agency and can be undertaken by the State only at some risk. Moreover, the problems of marketing and of standardisation of products are equally, if not more, important in so far as the rural and cottage industries are concerned.[3] Organisation is what is primarily needed and as long as the problem of organisation is not tackled simultaneously with that of finance the small industrialist is bound to find himself at a disadvantage before the entrepreneur of a large organised establishment.

1 Indian Central Banking Enquiry Committee, Majority Report, pp. 247-48.

2 *Ibid*, Vol. IV, p. 1062.

3 Report of the Industrial Finance Committee, Burma, p. 5.

CHAPTER XI

How Industries are Financed in Other Countries—A Brief Review and a Critical Estimate

The question of industrial finance in India and the policy of Government with regard to this particular problem have been so ruthlessly discussed in recent years that a proper analysis of the fundamental forces at work is impossible without a comparative study of the agencies of industrial finance in countries that are economically more highly developed than India. This study is also important from another point of view. Ever since the days when industrial finance in India presented itself as a problem of some magnitude to her economists and politicians, people have been loud in their complaints that India has not been following in the footsteps of some countries which possess "ideal organs of finance" for the promotion and development of their industries. The traditional and conservative ways of banking on the part of the Imperial Bank of India and other joint-stock banks have only served to confirm a suspicion that things are manipulated in this country in a certain way by certain people with interested motives. It has been openly asserted that in India the State evinces little or no living concern for the growth of industrial enterprise, and this lack of enthusiasm has been attributed by many to the overwhelming influence which foreign vested interests enjoy in India and also to the obvious fact that those

who govern and direct the industrial policy of the country have not in any appreciable way been responsible to the representatives of the people for what they do and omit to do.[1]

We shall start our study with England, not only because her models have been more or less copied in India, but also because her industrial life is decidedly longer and more varied than that of any other country in the world. The first thing that strikes an observer here is that the relations between the British financial world and British industry, as distinguished from British commerce, have never been very close. The prorietors of British banks have subscribed but a small proportion of their funds in industry and the requirements of the latter have been met more by the "extremely varied facilities and unrivalled financial machinery of the English capital market" than by the direct participation of banks in industrial ventures.[2]

This peculiarity has been due to historical reasons. In England commerce preceded industry and London's financial organisation adapted itself to the needs of her commerce. "The exceptional merits of the City of London lay in the facilities given by the short-term money market for the employment of home or foreign funds; in the financing of trade and commerce, also both home and foreign; and in the issue of foreign bonds, as distinguished from the financing of British industry." "On the other hand, when British industry began its

1 A very frank expression of this suspicion is to be found in the pages of the Indian Central Banking Enquiry Committee Minority Report by Mr. Manu Subedar (Calcutta, 1931).

2 S. Evelyn Thomas: British Banks and the Finance of Industry (London, 1931), p. 133.

great growth in the nineteenth century, there was no particular reason why it should look to the London market for the financial requirements. Industry in those days was, so far as each unit was concerned, on a comparatively small scale; the capital was provided privately and it was built up and extended out of profits; in so far as it required assistance from banks it found them from the independent banks, often family banks, which in general had their headquarters in the provinces, and particularly in the Midlands and the North, where the new industries flourished. Moreover, there had existed for many years a large class of investors with means to invest, who exercised an independent judgement as to what to invest in, and who did not rely as in some countries entirely on their bankers. Industry, therefore, though making full use of the banking facilities offered by the joint-stock banks, maintained its independence of any financial control."[1]

Generally speaking, industrial investment in England has not been "guided" by any institution or organisation of any standing or reputation. A few issuing houses have occasionally entered into the field of industrial promotion and the organisations of stockbrokers have often been known to give advice, but in the main banks or other financial institutions have never fathered an issue or been in any way responsible for it beyond seeing that the prospectus of a projected company complies generally with the law and that the issue is on the face of it respectable. There are practically no established houses to assist investors in subscribing to shares in local industries and enterprises; the real

[1] Report of the Committee on Finance and Industry (London, 1931), Cmd. 3897., pp. 161-62.

issuer is "the company itself, if it is a strong and good one, or a finance company or syndicate—few large, many small, some good, some indifferent, some bad—and sometimes it is a company or a syndicate got together for the sole purpose of making a particular issue."[1]

The current requirements of industry are supplied by the joint-stock banks. They increase the supply of capital by collecting lodgments from the public; by compounding these lodgments with their own capital and reserve funds they convert a large number of small quantities and short lengths of capital, individually ineffective, into an aggregate available for productive employment; finally, by a continuous redistribution of this capital among the points of highest yield they maximise its earning capacity.[2] This last service of continuous redistribution of available funds is performed in the City of London by the short term money market which gives facilities for the employment of home or foreign funds. (This money market supplies the day to day needs of industry with an elasticity and efficiency that are unknown in any other financial system of the world.) On the other hand, intermediate credit[3] and long-dated capital are not adequately supplied by this market, this being "due in part to the historical organisation of British industry and to the fact that industry, having grown up on strongly individualistic lines, has been anxious to steer clear of anything which might savour of banking control or even interference."[4]

1 *Ibid*, p. 167.

2 Lavington: *op. cit.*, p. 178.

3 Intermediate credit may be defined generally as credit advanced for periods ranging from one or two up to five years. There are at least three main types of transactions for which intermediate credit is required: (i) hire purchase or instalment sales, (ii) advances against deferred payments, (iii) long-term contracts.

4 Report of the Committee on Finance and Industry, pp. 169-71.

The most important feature of the English credit system is the Bank of England which stands at the apex of the whole banking organisation of the country. By its control over the cash base of the country the Bank of England is in a position to regulate the volume of bank deposits, so long as the joint-stock banks adhere to their normal practices in regard to the distribution of their assets, or indeed to offset any change which might be made in those practices. The link between the Bank and the commercial banks is established through the discount market "which is the first outlet of any surplus funds held by the banks and from which funds are withdrawn when the banks find it necessary to replenish their reserves." If the withdrawal causes a shortage of funds in the market, the market borrows in some form or other from the Bank of England and the accommodation given by the central institution provides the means of replenishing the cash resources of the commercial banks.[1]

In England businessmen thus depend on the ordinary credit mechanism of the country for the accommodation they require for purposes of trade and industry. For historical and sociological reasons the system has worked wonderfully well in spite of the fact that the contact betwen industry and credit has never been very close and intimate. The policy compendiously known as "*laissez faire*" has prevailed even in the domain of industrial finance. But with the rise of highly industrialised systems in other countries of Europe and in America, England has found that the old practice of "little conscious direction of the national activities to definite ends" no longer pays; the feeling has grown that her former

[1] *Ibid*, pp. 44-45.

easy-going ways would no longer ensure her prosperity in a crowded and increasingly competitive world.[1] The question of finding new and up-to-date agencies of industrial finance has attracted the attention of businessmen and financiers in England as well.

Recent years have seen the development of two new financial organisations in England : they are the Managed Trust or Finance Company and the Fixed or Investment Trust. In certain respects these two organisations are similar, but the former institution was in existence even before the War, while the Fixed or Investment Trust of Great Britain dates back to 1930 only.

The Managed Trust or Finance Company was "the application of scientific ideas and actuarial calculations to the investment field."[2] It specialised in the raising of funds for investment in long term securities. And its operations were numerous, consisting of investing funds, discounting bills, lending on approved securities, on mortgage of land and on house and shop property etc., dealing in land and houses, acquiring and developing and assisting commercial undertakings, underwriting issues of securities and converting businesses into joint-stock companies, receiving deposits, purchasing assets of insolvent estates and carrying on business as trustees and agents. Often, the Managed Trust operated mainly abroad and its activities were then more numerous and varied in character. Spread of risk was its basic idea and one unit of its stock would buy one a stake in anything from 20 to 2,000 different stocks, stores,

1 *Ibid*, pp. 4-5. "We may well have reached the stage when an era of conscious and deliberate management must succeed the era of undirected natural evolution "

2 Lavington : *op. cit.*, pp. 118-19.

bonds, debentures, and what not, in a number of countries.) "Management was the essence of this trust's operation.) At the back of the trust stood a small group of shrewd men or only one canny, alert, accountant-minded man ; and they manipulated the block of capital, taking advantage of new economic trends, selling and buying at the times which seemed to them most favourable."[1]

The post-war economic era, however, greatly undermined the growth and development of this Managed Trust or Finance Company. In this institution the efficiency, alertness and enterprise of the manager or group of managers were the things that lent stability and support to it. (The post-war world with its constantly varying and puzzling economic problems strained the extremely fallible human element in the Managed Trust system to an unusual degree and so there arose the need for a new investment institution in which the gulf between the choice to hold individual shares and a Managed Trust with a multitude of holdings could be effectively bridged.)

This new institution—the Fixed or Investment Trust of modern British economic life—was borrowed from America. In America there were two important factors at work in economic life: first, there was a very large class of small investors who wanted investment opportunities that would give them that spread of risk which it is generally possible only for the big capitalist to have; and secondly, the average American had become sick of the uncertain, fallible human element in managements. So the American people evolved the the Fixed Trust which offered investors the opportunity

1 *Ibid*, pp. 120-21.

of spreading an investment over many securities, fixed in number. Each unit of investment was composed of, say, twenty or twentyfive securities and an investor could buy a sub-unit carrying a fractional interest in each security in the whole unit.

The first British Fixed Trust made its appearance in 1931. Soon it gained in popularity and by the end of 1934, the total net sales of the Fixed Trusts organised and managed in great Britain were around £ 20,750,000. There are close on forty of these Fixed Trusts now in Great Britain.

Let us now see what exactly these Fixed Trusts represent. Roughly speaking, a Fixed Trust offers a definite holding, free from liability, in a fixed number of companies or concerns. The portfolio may consist of any field of investment, from gilt-edged stocks and foreign government bonds to industrials, insurance shares and gold mines, but the companies or concerns in which a particular fixed trust has invested are limited in number and known to every member of the investing public. The general principle is very clear. "A unit of shares is picked expertly and listed for all to see. The record of each company whose shares are chosen is available in plain figures and can be examined."

Management in a Fixed Trust is not left to the fallibility or caprice of an individual manager or a group of managers. "The Fixed Trust is given a life from ten to twenty years, and a bank or an insurance company agrees to act as trustee during the Trust's life under conditions explicitly laid down in the Trust deed negotiated with the management company. The number of shares to be bought is decided upon, the shares are purchased in

the market, and the certificates lodged with the trustee. The trustee issues the sub-units, representing a small fraction of the whole unit, and the investor buys them through his bank, his stock-broker, or by direct application to the Fixed Trust offiice. All dividends, bonuses, rights etc., are collected by the trustee who distributes them to the holders of sub-unit certificates......The operation is automatic, full-proof and fraud-proof."

The system has offered to the middle class British investor a unique opportunity for good investment where he can see things for himself and spread his risk over as many securities as he likes. The unit trusteeship of almost all the Fixed Trust companies having been taken over by one of the big banks or insurance companies, continuity of management and sound unspeculative business are fully assured. Ample capital and a wide free market have nullified the possibility of an over-large proportion of the shares of any one company being held by the Fixed Trusts. On the other hand, the sub-units have become a very convenient medium of long-term investment for that class of people who are neither gamblers, nor speculators, nor weak holders. Here is something on which individual investors can make up their own minds with reference to their own particular needs and fancies, the amount of risk they can take, the income they want, and the very full information which Fixed Trusts give in their literature as to what they offer.[1]

Let us now consider the case of the U.S.A. Here the connection between banks and industry has

[1] *Vide* my article in *The Commercial Gazette (Calcutta)*, dated July 29, 1935.

been more intimate than in England, but less so than in Germany. From the very outset the American financial world devoted itself more to the development of her industry than to international finance. In the building up of some of the national industries, and in particular in the merging of most of the great American corporations, some house or bank has invariably played a leading part, with the consequence that the relationship between them has usually remained a close and continuous one. "It may be said that all industrial issues of well-known companies are sponsored by some responsible issuing institution : the smaller issues by smaller firms, the larger by large firms or large banks. In both cases it is common for a group of issuing institutions to combine in making the issue. In every case the names of the issuing institutions appear prominently on the prospectus, so that the public are left in no doubt as to who is sponsoring the issue." "Moreover, the American banks are closely concerned with industry from another aspect. The banks lend either directly or through brokers very large amounts of money to investors and speculators against industrial securities of all kinds. The loans of this kind are sometimes at least equal to the loans made direct by them to industry."[1] The result is that banks in America are always specially interested in the stock market and in the industrial securities quoted there. In view of the fact, however, that the number of banks competing is large and the problem of finding the necessary capital from the public is much easier, the connection between banks and industry in the U.S.A. is not as close as it is in Germany.

[1] Report of the Committee on Finance and Industry, pp. 163-64.

Of the greatest importance, however, is a study of the relationship between banks and industry in Germany.[1] A very large section of Indians desire that India should take a leaf out of German industrial history and develop her industries accordingly. Even apart from this consideration, the study is important, because, of all the Continental countries, Germany shows *par excellence* how economic circumstances force bankers to associate themselves with industrial development on the one hand, and how industries themselves are forced to count on the support and guidance of banks on the other.

Let us first analyse the historical forces at work. The close association between banks and industry in Germany arose out of the necessities of the situation —from the scarcity of capital and of independent investors. "The comparative poverty of Germany about the middle of the last century and the great demand for capital to supply the needs of her rapidly growing industries led naturally to the development of banks which took a large and active part in providing the capital requisite for the creation and extension of business undertakings, both by the grant of long loans and by the floatation of joint stock companies."[2] In order to compete with England which had the advantage of an early start, industry in Germany had to turn to banks to obtain permanent as well as short-dated capital. Accepting the heavy responsibility of supplying capital to industry, banks on their part were obliged to keep in more intimate touch with, and maintain a more

[1] A very comprehensive account will be found in P. B. Whale : Joint-Stock Banking in Germany (London, 1930).

[2] Lavington : *op. cit.*, pp. 209-10.

continuous watch over, firms with which they had allied themselves than were the English banks.[1]

It was not exactly a shortage of capital that resulted in this peculiar relationship between German banks and industry. Capital there was, but it was misdirected. "Those who had the necessary funds were for the most part neither willing nor fitted to become progressive entrepreneurs themselves, nor would they trust their money with others who had the required qualities." Hence there was an urgent need for some agency which could obtain the confidence of the investing classes and use this confidence to direct their capital towards sound industrial undertakings. The new credit banks filled up this gap.[2]

The close co-operation between banks and industry in Germany was accelerated by some of the outstanding features of industrial and economic life there. During the closing years of the last century kartellisation or the association of industries horizontally related began to dominate the economic situation in Germany: industry became powerfully equipped through efficient organisation to meet competition abroad and to secure a stable and remunerative price in the home market. "But large and highly organised industrial interests called for large and similarly efficient industrial finance. The advantages which industrial groups had gained by close co-operation under the kartel system were realised by the banking interests, which not only began to form syndicates or

1 Report of the Committee on Finance and Industry, pp. 162-63.

2 Whale: *op. cit.*, pp. 10-12. S. G. Feodossief, however, attributes the origin of German joint-stock banking and its peculiar association with industry to "pure chance". See the Bankers' Magazine (London), June, 1930, for a history of A. Schaafhausenesche Bankverein.

konsortiums among themselves in order to distribute the risks and burdens of large-scale finance, but also began to demand representation on the advisory councils of the concerns or groups which they financed."[1] By the beginning of the twentieth century the greater banks had their recognised industrial areas so to speak.[2] The economic expansion had created on the one hand such heavy demands for credits of all descriptions and claimed on the other hand the public trust in snch a measure that, broadly speaking, the means and position of private houses were no longer equal to the requirements. The process of concentration and affiliation in industry had necessitated the broadening of the capital and credit basis of the banks themselves and this latter process in its turn enabled the banks to form a close alliance with industrial concerns.[3]

What is often overlooked in all discussions about the German banking system is that the special services to industry are performed not by a separate or special type of credit agency, but by the ordinary joint-stock or commercial banks. The various activities carried out in the British banking system by various kinds of agencies are executed in Germany by the joint-stock banks alone: these latter comprise the functions of a commercial bank, mortgage bank, discount house, issue house, company promoter, bill-broker and a stock-broker. "The German Great Bank, unlike the English Investment Trust, does not specialise in investment business alone, but combines the functions of an investment bank with those of an

1 The Bankers' Magazine (London), April, 1931.

2 J. H. Clapham: The Economic Development of France and Germany 1815-1914 (Cambridge, 1928), p. 384.

3 Leopold Joseph: The Evolution of German Banking (London, 1913), pp. 95-105.

ordinary commercial bank."[1] The ordinary credit banks carry on various lines of business which to an outsider would seem rather risky and speculative. But inside the integrated system there is a considerable amount of specialisation. The various routine transactions are done by the respective departments, while the higher financial activities, such as the floating of state and municipal loans, syndicate operations in connection with the promotion of industrial undertakings etc. are dealt with by the managing directors themselves with the help of their secretaries.[2] (Organisation, elaborate and methodical, characterises the German system and gives it power.) In banking, as in iudustry, though the individual units are often large enough by themselves, the method of the kartel is frequently adopted. On the one hand, each of the leading banks has a large group of allied banks working in general co-operation with it ; on the other, in addition to this primary grouping, they are specially organised in their own ways to deal with large financial propositions. The result is that in Germany risks which even the largest banks might regard as dangerous are made quite manageable by distribution.[3]

Let us now analyse the transactions between a bank and a particular customer undertaking. (These transactions are very varied—a sort of "an indivisible many sided whole, rather than a sum of separate relations.") (The first connexion arises in the matter of current account which is distinct from cheque account.

1 The Indian Journal of Economics (Allahabad), April, 1925.

2 Written Evidence of Dr. L. Nemenyi (Budapesth, Hungary) before the Indian Central Banking Enquiry Committee, Vol. II, pp. 286-87.

3 H. S. Foxwell: Papers on Current Finance (London, 1912), pp. 115-16.

When a current account relationship exists between the two parties, money claims arise on both sides and "these claims are not settled individually, but are treated as items in an account of which the balance is struck periodically". The average German firm depends to a remarkable extent on this arrangement not only for its working funds but also for the purpose of extending its permanent assets in anticipation of recourse to the investment market. The current account relationship is very important as it is a continuous connection and thus gives the bank an insight into most of the money transactions of a customer; it also provides much of the data required for estimating the risk involved in the intermittent capital transactions; and it leads up to capital transactions even more directly, in the sense that improvements and extensions of plant are often undertaken by means of current account credit which is repaid later with the proceeds of a capital issue. "The industrial current account is the pivot of all transactions between been banks and industry; promotion and issue transactions, direct participation in industrial undertakings and co operation in management through Boards of Supervisors—these stand in very many cases in a close causal sequence with bank credit."

The second important connexion arises in the matter of promoting companies and equipping them with capital. The more common method of promotion in Germany is what is called "the simultaneous method" whereby the entire capital is taken over in the first instance by the promoters themselves. What happens is this. After the plans of a new company have been examined and approved by a bank, a so-called "syndicate" (a sort

[1] Whale: *op. cit.*, pp. 37-38 and 51-52.

of temporary association of various banks and also of private men for the sake of floating a new concern) is formed and the shares of the new company are taken up by the promoters, that is, the members of the syndicate.[1] This, however, is only the first step. For the satisfactory termination of the whole transaction, the shares taken over at the the time of promotion have to be placed among the investing public. This also is done by the syndicate or konsortium. The time is always chosen carefully, according to the conditions of the share market. The syndicate divides the shares between the applicants, but the period of sale is always regulated so that shares can be sold at the highest price obtainable. In all this, banks play the part of middlemen only; they simply hold securities for a certain length of time, lasting participation in industrial undertakings never being the general policy of the credit banks.[2]

(The third and last important connexion arises in the representation accorded to banks on the Board of Supervisors of an industrial undertaking. This Board comes in between the Executive and the General Meeting of Shareholders to keep a check on the Executive in the interests of shareholders and has got considerable powers over both. By this means banks "strengthen their connexion with the undertakings in question and exercise more influence on their policy and more insight into its execution".[3])

Let us now analyse the working of this mixed banking system ~~and~~ see how it manages to maintain

[1] Written Evidence of Dr. Nemenyi: *op. cit.*, pp. 289-90.

[2] Whale: *op. cit.*, pp. 46-47. Only when an issue proves unsuccessful or securities have to be brought back from the market in order to maintain their price, is the period of holding securities extended almost indefinitely. Such a participation is no more than involuntary and incidental.

[3] Whale: *op. cit.*, pp. 49-51.

such a close alliance with industry without involving itself in danger. The first thing that strikes an observer is that every line of the activities of such a bank is self-balancing. "The short-term deposits are used only for short-term credits, whereas the loans on long terms are based, without exception, on such resources as can be safely locked up for long terms. The latter are granted to industry and agriculture in the form of debentures and the debenture bonds which are issued against these loans are again sold to capitalists who are willing to invest their money for a long period against a guaranteed interest".[1] It cannot be said that German banks unduly "lock up" their assets. They can take such an active share in industrial banking simply because they have vast resources of their own and hold larger reserves.[2] Although it is true that German banks do invest in the shares of their customers' concerns, it is not true, contrary to the general opinion held in India, that they tie up their depositors' funds to any appreciable extent in illiquid assets. The total of illiquid assets is almost invariably covered by the capital aud reserve resources of a bank. Then again, even when a certain amont of "locking up" becomes unavoidable, the risks are mitigated, firstly, by diversifying their interests and, secondly, by maintaining secret reserves. Thus, in syndicate operations the capital invested is constantly changed from one investment to another and the holdings of banks in the different syndicates are kept very confidential.[3]

1 Written Evidence of Dr. Nemenyi: *op. cit.*, pp. 292-93.

2 Reisser tells us, as the result of an enquiry into 169 banks, that the paid-up capital and reserve of these banks was 45% of their liabilities, while the proportion in England at that time was only 9% Cf. also Foxwell: *op. cit.*, pp. 116-17.

3 Written Evidence of Dr. Nemenyi: *op. cit.*, p. 293.

Before we pass on to considering the methods of industrial finance in Japan, let us make an estimate of the German system and see how it compares with its English and American prototypes. England is the land of an excessive division of labour but the system suits the temperament of her people and has got historical forces behind. In America the process of specialisation is less marked; although banks come to the front to assist in the promotion and financing of industrial undertakings, the contact is by no means as close as it is in Germany. In Germany, banking is more non-specialised than it is even in India, and it is indeed a marvel that ordinary commercial banks should engage in activities of so diverse and complex a character and yet maintain their soundness and liquidity. As we have seen already this is achieved by a punctilious insistence on self-balancing transactions and by a judicious distribution of risk. The German system supplies very efficient machinery for investigating business ventures and provides the financial strength necessary to sustain the heavy risks to which industry is exposed. The companies enjoy expert financial advice and assistance; the banks, by virtue of their position as directing heads of industrial groups, obtain a comprehensive view of economic conditions which enable them to promote amalgamations and introduce or, if necessary, even to force through schemes of rationalisation or other remedial measures. The investing public also benefit in as much as it obtains as a matter of course a large measure of security through the active intervention of banks.[1] Moreover, as the German banker undertakes a more definite responsibility and a greater risk in connection with capital issues, he

[1] The Bankers' Magazine (London), April, 1931.

is naturally more concerned about the success and lasting stability of the securities issued under his name than the average English banker.

On the other hand, certain weak features of the system should not be overlooked. While the charge of having caused the annihilation of small businesses in Germany cannot be laid at the door of the credit banks, it cannot be denied that one of the far-reaching results of the direct intermingling of the vital interests of the banks and of industry has been that the value of the small capitalist and investor has been somewhat overlooked and the State has often been forced to step in to avert a crisis.[1] Moreover, in the years before the War, the ordinary industrial or commercial firm of moderate means often found its freedom of action conditioned by the good-will of its bank, even when it was in a sound and fairly prosperous state itself.[2] Although initiation in industrial combination did not actually come from banks, it is difficult to dispute the fact that banks had some part in the development. At a very early stage they helped to prepare the way by encouraging fusions between individual undertakings and so reducing the number of competitors. Throughout their attitude was sympathetic even while it remained passive. Finally, once the plans for combination had reached a certain stage and were within a measurable distance of fruition, the banks gave active support to ensure their success.[3]

Another weakness lies in the relation of banks to the short-term money market. In their desire to meet the

1 The Bankers' Magazine (London), April, 1932.
2 Whale : *op. cit.*, p. 55.
3 *Ibid*, p. 62. See also Clapham : *op. cit.*, p. 394.

credit needs of their industrial customers on the cheapest terms, the banks place their acceptances at the disposal of their customers to a very large extent. Such acceptances are largely used to obtain long-term credits. Now, a demand for long-term credit for capital investment means more bank acceptances and a tendency towards over-burdening of the money market, with the result that the interest rate of legitimate short-term credit reflected in the discount rate is forced up without justification and at a time when trade expansion may be vitally necessary.[1] The practice of the banks employing the nation's liquid resources as long-term advances to industry has had disturbing influence in the money market on more occasions than one and, paradoxical through it may seem, the rapid reconstruction of Germany's industrial plant after the War with the active help of banks has been, through its effect on the money market, a major obstacle to the desired expansion of the country's foreign trade.[2]

In spite of these weaknesses, the system has undoubtedly been suited to the genius of the German people and been a signal success so far as the industrial development of the country is concerned. The banks have assisted with their credit in the development of production on a large scale and their concentration and decentralisation of establishments combined with an elaborate and methodical organisation have enabled them to keep a finger "on everything that is going on." Finance and industry have gone hand in hand and the grim determination of the German people to achieve a rapid economic development has only strengthened this process of alliance. The influence of the pre-war

[1] The Bankers' Magazine (London), June, 1930.

[2] J. W. Angell: The Recovery of Germany (New Haven, 1929), p. 214.

bureaucracy is also not negligible: it is this bureaucracy that ensured economic stability by restricting the liberty of the industrial unit and thus built up a banking tradition which lost none of its essential characteristics during the difficult War and inflation years.[1]

Post-war developments in Germany have, however, revealed the weaknesses in this relation between banks and industry to a large extent. War profits increased the power and independence of industry as against banks and banks were seriously affected by the fall in the value of the mark.[2] Although stabilisation came after some time, banks could not go back to their strong pre-war position. As a matter of fact, the latest balance-sheets of the leading German banks, while showing substantial expansion in resources, seem to bear a greater resemblance to the normal English balance-sheet than did the majority of the German balance-sheets in pre-war days. Moreover, the melancholy bank failures that took place in Austria and Germany in 1930 and after showed far too clearly that the system of mixed industrial banking had helped to make Germany's economy more vulnerable. Germany's economic depression of 1932-33 was no doubt aggravated, and her financial crisis caused, by the destruction of Germany's working capital during the inflation period and the sudden withdrawal of foreign confidence and money, but there is not a shadow of doubt that her system of intimate alliance with industry had made her position inherently weak.[4] So when the crisis came nothing could stem the steepness of the crash.

1 The Bankers' Magazine (London), June, 1930.

2 H. Schacht: The End of Reparations (Tr. by Lewis Gannett), London, 1931, pp. 99-101.

3 The Bankers' Magazine (London), July, 1930.

4 Dr. Erich Roll in The Bankers' Magazine (London), February, 1933.

We shall now turn to Japan the rise of which as an industrial power has been the marvel of the last fifty years. In Japan banking is of a specialised character, each class of banks catering for a special class of demand. There are the home trade banks, foreign exchange banks, agricultural banks, industrial banks and colonial banks. This demarcation of functions proved to be of great value in the early years of economic development in Japan because it enabled the central institution, the Bank of Japan, to exercise a necessary and beneficial control over almost every department of the economic life of the nation at a time when such control was very necessary.[1] On the other hand, in order to effect a rapid industrialisation of the country, Japan was led to copy foreign systems and incorporate them into her own life. As, however, her money market was very poorly organised and there was a distinct scarcity of capital and there existed no mercantile community possessing sufficient ability or knowledge to take the necessary steps, the country had to rely on trained government officials who had studied foreign systems and who alone were competent to undertake the task of creating a new banking organisation.[2] The result was that the State was compelled to keep a close watch over the direction of industrial and commercial expansion and the Japanese banking system became, in a large measure, the creation of the State.[3]

In spite of state control and guidance, the Japanese banking system has tended to be a loose one and the

[1] J. Inouye: Problems of the Japanese Exchange, 1914-26 (Tr. by E. H. de Bunsen), Glasgow, 1931, pp. ix-x.

[2] J. E. Orchard: Japan's Economic Position (New York, 1930), pp. 243-44.

[3] G. C. Allen: Modern Japan and its Problems (London, 1928), pp. 147-48.

functions of the several distinct groups have been more or less mutually exclusive. The Bank of Japan has never been able to co-ordinate the financial activities of the country nor has it been able to provide the money market with an elastic supply of funds even in normal times. The Bank of Japan has been an institution mainly for currency control, for conducting official financial business and for help in emergencies.[1]

It is in the light of this that we should consider the nature and functions of the special institution that exists in Japan for the financing of industrial ventures. This is the Industrial Bank of Japan founded in 1900 on the model of the Credit Mobilier of France. Here also regulations have been drawn up to ensure strict governmental supervision over its affairs. Its business consists chiefly in making long-term loans to industrial concerns on the security of national, prefectural or municipal bonds, and on mortgages of land, buildings, factories, ships and railways. A great part of the advances go to newly established or weaker industries which the Government either initiated or has been partly interested in. The term of such loans is usually five years and funds are raised by the issue of debentures. It is asserted that by this means newly established or weaker industries are given a chance to withstand the competition of other ventures both within and without Japan.[2]

We should not, however, overlook certain fundamental factors in the situation. The intimate control of the Government over the affairs of the Industrial Bank has led to a certain amount of rigidity and conser-

[1] *Ibid*, pp. 157-59.

[2] *Ibid*, pp. 163-65.

vatism that is not noticeable among institutions free from state control.[1] Moreover, a considerable proportion of the Bank's capital is held by foreigners and it is debatable how far this is to the good of Japanese national interests. On the other hand, the close relationship that exists between banking and industry is due to factors that having nothing to do with the Industrial Bank of Japan, and the Government has frequent occasions to encounter rebuff from groups of industrialists and bankers. Almost every great Japanese business firm appears to have established a bank in connexion with it, with the idea no doubt of strengthening its own financial position by rendering itself independent of the outside money market. Many of the most powerful of the bankers are primarily industrialists themselves and hence Government often finds it very difficult to carry out its economic policy through its own institutions like the Industrial Bank or the Bank of Japan. The industrial progress of Japan is attributable not to its Industrial Bank, but to the conscious and determined efforts of her people to build up enterprises on the lines of the countries of the West.[2]

1 K. Yano in the *Banker* (London), June, 1926.

2 Allen : *op. cit.*, pp. 174-75.

CHAPTER XII

The Chief Financial Handicaps and Suggestions for Remedy

So far we have considered the problem of financing industries in India from the aspect of industry as well as of banking. We shall now analyse what the chief defects in the financial system are which have an adverse influence upon the progress and development of industries. Our purpose in this chapter will also be to show the lines of remedy.

We have seen that the existing facilities to meet the financial requirements of industries are regarded by many as inadequate. Industries complain that banks do not provide finance for block capital even when adequate security is offered, and that even with regard to short-term loans they insist on a full backing of tangible and easily realisable security and take no account of the personal credit and integrity of the borrowers. It is also regretted that joint-stock banks in India do not have experts for valuing the assets of an industrial concern and for judging whether a concern is profitable and solvent or not, and this makes it difficult for them to gauge the soundness or otherwise of a new enterprise. Finally, the system of advances made by banks for short periods only is regarded by all industrialists as a distinct menace to a stable economic development, and the alternative method of securing funds from Managing Agents or direct public deposits is undoubtedly crude, primitive and dangerous.[1]

1 The Indian Central Banking Enquiry Committee, Majority Report, (Calcutta, 1931), pp. 169-71.

These are pertinent criticisms, but on a closer analysis it would appear that many of these alleged defects cannot be laid at the door of the existing financial agencies. The argument that banks should provide finance for block capital is against all the canons of financial propriety; initial block capital should always be put up by public or private subscription, and even in Germany, which is held to be the model India should follow, none of the banks provide finance for block capital. Their share and syndicate operations are in the nature of guarantees only: they never supply the initial block capital themselves.[1] It is not the function of a bank to provide fixed capital, and even such capital as is needed for subsequent improvements and extensions should either be supplied out of the undivided profits of a concern or obtained by an increase of share capital or an issue of debentures. When critics in India point to the current account system that prevails in Germany, they forget that the success of the system has been largely due to the fact that the savings of the community there (which are the ultimate source of capital) have been poured into those credit banks in enormous quantities for years together.[2]

As regards the complaint that joint-stock banks in India insist on a full backing of tangible and easily realisable security, it is difficult to see how things can be improved when the series of crises that have occurred owing to bad and speculative advances are considered. Perhaps their policy is a bit too cautious and conservative, but "the restrictions imposed by the

1 S. G. Feodossief in The Bankers' Magazine (London), June, 1930.

2 Solomon Flink: The German Reichsbank and Economic Germany (New York, 1930), p. 257.

necessity of conforming to conservative methods of banking have promoted a healthy growth which would have been absent from any form of subsidised assistance unless guided by a staff of experts as in the case of the German credit banks."[1] Moreover, it is a fact that the expert help and guidance which are available to German credit banks are not obtainable in India, and this is due to the more fundamental reason that scientific and managerial experience in the various lines of industrial activity is still rare in this country.

The point that joint-stock banks in India do not grant any long term credit to industries is easily met. It is almost a truism that good banking presupposes a series of self-balancing transactions, and hence joint stock banks whose assets consist largely of customers' deposits liable to be withdrawn at short notice, cannot obviously, without incurring serious risks, lock them up in long-term advances or loans. It should not be overlooked that in countries where joint-stock banks make some sort of long-term advances to industry, these particular transactions are conditioned and limited by the nature and extent of that amount of their capital and deposits which are not likely to be recalled for certain definite periods of time. We should remember in this connexion that the business of the German credit banks is "composed of credit relations in a balanced combination" and their balance-sheets give no support to the popular idea that they are essentially investment or holding companies. Moreover, even in Germany the larger financial transactions of these banks (e.g., the promotion of companies, the taking over of new capital issues and obligations of existing companies,

[1] Written Evidence of the Allahabad Bank Ltd., before the Indian Central Banking Enquiry Committee (1931), Vol. II. pp. 1-2.

the taking over of public loans etc.) are definitely subordinate to their ordinary commercial operations.[1] It is no wonder, therefore, that Indian banks with a poorer equipment and an infinitely more uncertain investment market should hesitate to embark on long-term industrial commitments.

This defence of existing practices does not mean that all is well nor does it establish the thesis that no further improvements can be made in the present state of our economic development. The absence of a real Central Bank was the most formidable drawback so long and the system of dual responsibility of the Government and the Imperial Bank of India which existed until recently was far from satisfactory. While it is easily possible to expect either too much or too little of Central Bank action, it cannot be denied that such an institution is both an instrument and a force: as an instrument it is the means by which its executives can give effect to a national economic policy; as force it has certain powers in its keeping which can be used to achieve the ends of such policy.[2] The newly established Reserve Bank of India is expected, by a mobilisation of the banking and currency resources, to mitigate the evils of a fluctuating and high price for the use of credit available for trade, industry and agriculture. And the existing joint-stock banks will, it is hoped, now be able to meet the financial demands of industry better by virtue of the increased facilities they would be getting from the Reserve Bank through the re-discounting of bills.[3]

[1] Whale: *op. cit.*, pp. 25-26 and 162-63.

[2] Report of the Royal Commission on Banking and Currency in Canada (Ottawa, 1933), p. 63.

[3] Evidence of Mr. S. N. Pochkhanawala (Managing Director of the Central Bank of India, Ltd.) before the Indian Central Banking Enquiry Committee, Vol. II, p. 141. The recently established Reserve Bank of India foreshadows to remove some long-standing grievances of Indian industries.

Something may perhaps be done by the Imperial Bank of India and other joint-stock banks. The Imperial Bank in particular has been looked upon with a certain suspicion by Indian industrial concerns and not infrequently the charge of racial discrimination has been hurled at it. As an institution occupying, until the other day, a position analogous to a Central Bank and enjoying privileges and facilities that are denied to the ordinary joint-stock banks, it has a great responsibility to the country and the sooner it can remove all possible causes of suspicion the better it will be for all concerned. Moreover, in any banking re-organisation of the future the Imperial Bank of India with the enormous experience and training of its officers is bound to play a very important part; and it would be doing a great service to Indian industries in general if, now that the Reserve Bank has been established, it started making a survey of the general industrial situation here, with a view to taking upon itself some of the work that is performed by German credit banks for industry in their country.

This work, it is suggested by some, should forthwith be taken up by the Imperial Bank and other joint-stock banks. Enthusiasts tend to forget, however, that until there is a better and more harmonious industrial development of the country, the Imperial Bank or any bank for that matter can hardly embark on operations that are admittedly risky and, to a certain extent at least, speculative. It should not be overlooked that the German type of mixed business requires much experience and an established policy and tradition of sound banking, both of which are wanting in India. "It also demands considerable capital and a firm resistance to the temptation

to speculate which easily arises in a line of business where securities are created and sold. The bulk of the joint-stock banks in India are not at present ready for this activity, and even the larger ones can cultivate it only slowly, with great caution and preferably under competent guidance." On the other hand, they can certainly cultivate a more sympathetic attitude towards industries and while they must not allow themselves to be drawn into liabilities and investments which are incompatible with sound banking, they may copy the *spirit* of the German model and "establish useful liaison between themselves and industries by appointing one of their Managing Directors or Managers as one of the directors of the industrial concerns financed by them." With the same end in view banks should be encouraged to appoint local Advisory Committees which may supply reliable information regarding the status and financial position of their clients.[1]

The great difficulty is that even now the average Indian dealer or entrepreneur resorts by preference to the shroff who sits in a little bazaar shop and is familiar with the means, character and trading methods of his client; he is content to pay the shroff's charges, high though they may be, rather than "expose himself to the enquiries, the regularised procedure and (as he believes) the greater risks of a joint-stock bank with a grilled counter and a uniformed peon in the doorway." A regular bank would demand of him a trade-bill, a deposit of valuable securities, or at least a friend's counter-signature on his promissory note; the indigenous shroff, on the other hand, lends on personal knowledge and often on a simple personal

1 The Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 296-98,

bond, relying on his acuteness to forestall, or on the pressure of his caste-fellows to compromise, a possible failure of his debtor. The result is that joint-stock banks are left in the air : most of the agricultural and a fair proportion of industrial business is done without reference to them and it is only when a shroff finds his own capital, supplemented by the deposits of his friends, insufficient to meet the demands of his clients that he turns to the banks for credit. Thus the Indian joint-stock banks remain only urban bodies, and as the indigenous shroff does not desire to surrender his independence and become a manager of a bank on a fixed salary, the banks find themselves in the unenviable position of having to conform to strict banking methods and thereby alienate a considerable section of potential clients.[1]

The fact that the greater portion of trade and industry in India is financed by shroffs would not have mattered so much if the work of the shroffs were regulated by some legislation. As it is, their work is not co-ordinated with that of the modern banks, and is, therefore, outside the range of control of even the new Reserve Bank. It is very desirable that steps should be taken "to safeguard, if possible, on the one hand, the interests of the shroffs, who certainly do a most important work, and, on the other, to regulate the same in such a way that it may be assigned its due place in the credit system of the country." This is an aspect of the problem which the new Reserve Bank of India may well study in great detail.

This brings us to the question of lending on the personal security of the borrower. It is asserted that

[1] The Banker (London), June, 1930.

in India banks demand tangible security as cover for each one of their advances while in countries of the West the custom is to lend a great deal on personal security. This practice, it is stated, is specially inconvenient to the cotton mills of Bombay and Ahmedabad which depend on deposits from the public for their mill finance, as the grant of security by the mills in the form of hypothecation of stock would affect most prejudicially the whole fabric of their credit. Now, so far as the question of granting clean credits is concerned, it is important to remember that even in the West such advances are limited to big firms of undisputed standing. Without making any reflection on the soundness and honesty of Indian enterprises we may say that none of them have yet attained that tradition of stability which may warrant the grant of clean credits to them by the undoubtedly weaker banks of this country. The reluctance of existing banks to afford such accommodation to industry is not due to sheer obstinacy or fetish : it is due to the fact that they are ill equipped to make advances that involve an uncertain and doubtful locking up of funds.[1]

The immediate great problem in respect of the money market in India is to create an instrument which is acceptable to all parts of the banking organisation, which is not exclusively dependent on the standing and respectability of the borrowers and which represents a real value in non-perishable, readily saleable goods. The fundamental conditions for a bill market being absent in India,[2] it is necessary

1 Evidence of the Bengal National Chamber of Commerce before the Indian Central Banking Enquiry Committee, 1931, Vol. II, pp. 486-87.

2 See *supra*, Chapter VIII.

that the credit system should be based on the security of valuable and liquid assests such as bonds, shares and moveable goods. In certain countries (e.g. Java) where no true money market and no inland bills exist, loans and advances are made against the warehouse warrants or warehouse receipts representing such securities. India, too, should develop the method of licensed warehousing: firms requiring temporary accommodation should store their raw products or manufactured articles in these warehouses and the receipts issued against them should be used as collateral for loans which commercial banks are ordinarily able to make on the strength of covered bills. An organised and well-managed system of warehousing would certainly enlarge the basis of credit and facilitate the grant of advances by bankers to industry and trade.[1]

A system of licensed ware-housing may also indirectly strengthen and develop the bill market in India. But this by itself would certainly not be sufficient. Certain definite steps are needed in order to combat the system of cash credits which is so much in favour among borrowers in India. A specially low bank rate for discounting bills as compared with the rate at which the new Reserve Bank is willing to make advances against securities is likely to promote the habit of using bills; the present high stamp duty on bills may also be reduced[2]; and an intensive propaganda in favour of the advantages of the discounting system may be made.[3] Two important ways of a sound expansion

1 Memorandum by Dr. L. J. A. Trip before the Indian Central Banking Enquiry Committee, 1931, Vol. IV, pp. 362-63.

2 The present rate of stamp duty on bills is 18 pies per cent. As the bills current in the market are generally payable at 61 days, the duty works out at 9 pies per cent per month or 9 annas per cent per annum.

3 Bhatter and Nemenyi: *op. cit.*, pp. 119-35.

of currency and credit in the existing economic circumstances are the development of the bill market and the introduction of discounting and re-discounting facilities. It is hoped by many that the creation of the Reserve Bank with the resultant co-ordination of the various elements of the money market and a unified control of credit and currency would do much to develop the use of commercial bills and ultimately create an active and efficient discount market in India. On the other hand, it is very doubtful if there will ever be a developed *internal* bill market in India: there is not one in England. The most that could happen is that an exporter would draw rupee bills, and part of the sterling bills would then be diverted to rupees. But even this is not likely to happen so long as the present tendency to kill both imports and exports exists. Until the British exporter wants Indian goods very badly he will not certainly accept a rupee bill.

Let us now evaluate the services of the Managing Agency system as an instrument of finance in India. That Managing Agents provide a considerable part of the capital required by an industry both directly and indirectly has been noticed already, and we have seen that so long as the Agents remained efficient and up-to-date it was not a bad arrangement from the standpoint of the concerns they managed. But in recent years the weaknesses of the system have been brought out rather too glaringly by the economic depression: Managing Agents have been found to be unduly conservative and most reluctant to embark on new ventures. Thus in many cases they have been unwilling to avail themselves of such facilities as banks are prepared to offer on the ground that it would involve visible control by the banks and would lower their

standing in the eyes of the creditors and of the investing public.[1] In spite of its many services in the past, it is an economic anachronism in these days and vigorous attempts are necessary in order to make industrial enterprise in India less dependent on it for future development and also to establish direct friendly relations between industrial companies and commercial banks.[2]

The most fundamental drawback in the financial organisation is the lack of cohesion and co-operation between the different agencies. There was no real Central Bank until the other day; the connexion between the joint-stock banks and the Imperial Bank of India which stood in the place of a Central Bank was fitful, unregulated and haphazard; and the indigenous banking community is, as we have seen already, still practically outside the pale of the organised money market. It is no wonder, therefore, that in such an atmosphere even the agencies that exist cannot contribute their full quota. The establishment of a sound Reserve Bank was an imperative necessity so long, as without such an institution it was not possible either to effect co-ordination between the different units or to pursue a far-reaching economic policy. The old division of responsibility between the Government and the Imperial Bank of India had little to commend itself: unity of policy and unity in its execution were supremely necessary and it is gratifying to note that at long last a Reserve Bank has been established in India.

[1] Report of the Indian Tariff Board (Cotton Textile Industry Enquiry, 1927), Vol. I, pp. 91-92.

[2] Indian Central Banking Enquiry Committee (Majority Report), 1931, p. 280. Cf. The Indian Journal of Economics (Allahabad), January 1931: "They tend to act in a groove; there is no co-operation between different Managing Agents; their financial resources are limited; they do not and cannot have that intimate contact with the investing public which is possessed by banks."

We should not in this connexion forget the lot of the small industrialist. Although the problem of the small industrialist is not mainly one of finance, we have seen before that having little security to offer which would be acceptable to the joint-stock banks, they tend to fall into the clutches of the *mahajan* and the indigenous banker whose methods of business are primitive and rates of interest very high. The co-operative movement has not yet made much headway in this direction and we can only hope that the efforts of the people as well as of Government will be turned towards fully exploring this avenue. Those provinces which have got State Aid to Industries Acts should also apply them more liberally than they have done up till now and as the question of financing rural and cottage industries has got more local than general peculiarities, intensive local investigations are also necessary. An economic survey in each province is the preliminary reconnaissance on which the whole question of helping and encouraging the small man ought to be based.

We shall now consider the feasibility of establishing an Industrial Bank on the Japanese model in order to finance new industries and also to help old industries, intrinsically sound, but which have fallen on their evil days for reasons beyond their control. The arguments advanced in favour of establishing an institution of this kind are many and various. Indian capital, it is said, is shy and only an Industrial Bank could mobilise it and turn it into productive channels of investment. Such a bank, it is hoped, would be of immense benefit to the country in guiding its industrial development on sound lines. "It would be able, by its experience and knowledge gathered from

all parts of India and tabulated by a well-equipped intelligence department attached to the bank, to act as a guide and friend to all industrial concerns in India, young and old. It would prevent uneconomical and wasteful efforts to start industries in places where there are no possibilities and it would itself be in a position to formulate schemes for industrial development besides analysing and criticising propositions placed before it for financial assistance and support."[1] The establishment of an Industrial Bank with Government participation in its shares or debenture capital, or Government guaranteeing interest on the debentures is expected also to inspire confidence on the part of the investor anxious to invest in securities of an industrial nature—a confidence that is singularly absent in India to-day for a variety of reasons.[2] Such an institution, it is asserted, would be fully equipped to provide long-term loans to an industrial concern and would thus minimise the risk of a sudden demand to repay deposits which threaten quite a number of enterprises these days.[3]

Now, certain general observations on the project of such an Industrial Bank or Corporation will not be out of place here. A considerable proportion of its share or debenture capital will have to be taken up by Government, or interest on the debentures will have to be guaranteed by it. Direct financial participation of this nature by the State is of doubtful utility and it is important to recognise that if Government participates in, or guarantees, the capital issues of such a bank, it will have to poke its nose into affairs which should properly belong

[1] *Ibid*, pp. 284-87.

[2] *Ibid*, pp. 299-300.

[3] The Economist (London), August, 9, 1924.

to individual enterprise. Nor should we forget that in India industrial organisation is still backward and the range of choice for investments limited. Those who pin their faith in industrial banks or corporations tend to forget that of the hundred and odd banks which failed during the six years from 1922-27 a large percentage was brought down by investment in industrial enterprises.[1] Moreover, a relatively large amount of capital will be required in an Industrial Bank of this nature and a high rate of return would be expected on long-term investments because private investments on good security can themselves fetch as high a return as $12\frac{1}{2}$ per cent. In these circumstances it is highly problematical if an institution which devotes itself exclusively to long-term investment business will have much chance of success.[2]

The fact is that the starting of industries is never a bank's affair: an enterprise that wants accommodation must possess certain essentials (its block capital and normal working capital) before it can hope to get help from a bank. Moreover, it will be sheer foolhardiness to overlook the fundamental factors in the economic equilibrium which would tend to make the services of an Industrial Bank meagre and superficial: with an efficient investment market lacking, no amount of state guarantee can make a bank of the proposed type work successfully.[3] The first essential is the existence of an energetic body of entrepreneurs who are prepared to risk their own money and stand on their own feet i.e. without subsidy and without protection of any sort.

1 *Ibid*, April 12, 1930.

2 The Indian Journal of Economics (Allahabad), April, 1925.

3 The Indian Central Banking Enquiry Commitee Report, Vol IV, pp. 175-78.

Another condition for the development of industrial banks is that there should first be a larger and more efficient organisation of ordinary deposit banking in the country. Any form of banking can develop and fllourish only through an organic growth, and while the natural desire of Indians to accelerate the industrial development of the country is perfectly understandable, we cannot afford to shut our eyes to realities nor can we ignore the strain that any bolstered up scheme is likely to impose upon the economic system of the country. State help is certainly useful and should be exploited with profit, but the natural movement of economic forces cannot also be lightly ignored.[1]

[1] Evidence of Dr. Nemenyi : *op. cit.*, Vol. II, pp. 305-06.

CHAPTER XIII

We started our enquiry with a consideration of the fundamental problems of capital and industrial finance, and we found that currency and bank money are but forms of command over capital and that the basic problem of capital is that of time valuation. It is a problem of spending and investing, of deciding between various possible enjoyments constituting income. The task of the economist is to analyse all these underlying forces and to suggest means to give them full and free play so that an equilibriated condition may be established.

"The development of banking depends to a very great extent on the growth of the investment habit which in turn depends on the earning capacity of the people, their will to save, the incentive to save and the facilities for investment."[1] In India neither of these factors is adequately developed, and hence it seems a bit premature to talk about grandiose schemes of industrial finance without taking stock of these basic factors. If our survey of the history of industrial finance in India has proved any thesis, it has certainly shown the futility of having grandiose schemes when the forces on which a scheme and its success rest are not in equilibrium. On the other hand, our survey has made it clear that throughout the whole period of India's industrial history her equipment for financing industry has more or less kept pace with

1 Indian Central Banking Enquiry Committee (Majority Report), 1931, p. 432.

the imperfectly developed economic forces that have shaped her industrial destiny.

We shall start with a consideration of the factor of productive capacity. Now, both agricultural and industrial efficiency in India is strikingly low and hence the surplus left with the population of the country is small even in normal years. "To the few wealthy agriculturists who have a surplus during prosperous seasons, land or jewellery has greater attraction as a form of investment than interest-bearing bank account, postal cash certificates, Government securities or industrial stock. Moreover, the landed aristocracy in several places is far from solvent."[1] On the other hand, the commercial community and the salaried and professional section of the middle class have the will to save, but their capacity is very low compared with that in any other country, because the calls on them are great. "Social institutions in India make great depredations on individual savings in the support which has to be given to relations and others in cases of distress, temporary or permanent, ceremonies and charities. There are no rules of retirement—there is no scheme of insurance."[2]

The fact is that India is inherently poor, which means that there are not many in the community who have a surplus to spare. But the poverty of the population is not the only factor at work. The desire to save is also conspicuously absent among certain classes and, even where it exits, it is diverted to wrong and unprofitable channels. The general preference of the people for land investment is a great stumbling block

[1] Indian Central Banking Enquiry Committee (Majority Report), 1931, p. 432.

[2] *Ibid*, (Minority Report), 1931, p. 350.

in the way of the growth of capital in India. Even merchants and indigenous bankers invest their funds largely in the purchase and mortgage of land and buildings, and the preference of the professional classes for this particular form of investment is almost a by-word to-day.

Next to land, jewellery is a form of investment common both to the rich and the poor, the town and the country. Every year large sums are invested in ornaments and jewellery in every province: it is a practice rooted in ancient custom and usage. Various economic and social causes have influenced its growth. The habit originated in the lack of adequate banking facilities, of suitable means of investment ensuring safety and of ready realisability of savings. The Hindu law of inheritance applicable to certain sections of the community debarring women from receiving any share of immovable property has also encouraged the practice of giving *stridhan* to women in the shape of gold ornaments at the time of marriage. Although with the spread of education and the introduction of the banking system this habit of investing in ornaments and jewellery has diminished to a certain extent, the predilection still continues and can be removed, if at all, only by a diffusion of education among the masses, extensive propaganda regarding the economic use of one's savings and improved banking facilities.[1]

This brings us to the question of hoarding. The word "hoarding" has, however, been very loosely used and requires careful definition. What is injurious from the standpoint of economic development is the locking

1 *Ibid*, (Majority Report), pp.432-33.

up of surpluses in gold or silver bullion or coin, and not the industrial use of the precious metals. The charge of India's hoarding habit has been hotly discussed and repudiated and comparative statistics have often been cited to show that India's absorption of gold has never been abnormal or spectacular. Nevertheless, when we consider the unusually low *per capita* income in India we cannot help remarking that her absorption of gold, although not perhaps abnormal, is something which cannot be warranted as the requisite proportion for a poor and imperfectly developed country like herself.

A very important aspect of this outlook of the people is shown in the general preference for Government securities, postal certificates and similar issues which are unquestionably sound and carry the credit of the State behind. Although investment in industrial securities has made a long headway in India during the last twenty years, it is still very surprising how very quickly a Government loan or issue is taken up while industrial securities with good prospects are left in the cold for months and even years together. This preference for Government and similar securities is partly due to the fact that in India it was the State that was left to formulate, finance and execute large programmes of capital expenditure on various kinds of public utility services. At first funds were obtained from external sources as there was a general belief that the Indian capital market was unresponsive to appeal for such funds, but during and after the War extraordinary financial circumstances compelled the Government to apply more and more to the internal market. The result was startling: rupee borrowings in India were a conspicuous success and Government

found that there was always a class of potential subscribers in India ready to invest their funds in such loans.[1]

The general apathy for industrial securities is also due to the absence of a regular investment market in India and of organisations "for investigation into the merits of industrial issues, for underwriting such issues and for marketing the securities". But the most important fact is that investing classes in India have not yet learnt "to think industrially, to take and make bold ventures, to have a long view of things." This accounts also for the curious fact that in India debenture issues of industrial concerns are not popular except to a small class of speculative investors, and that only the standing and reputation of firms of Managing Agents would make them somewhat marketable. The Stock Exchanges at Bombay, Calcutta and Madras play a useful part in directing the flow of capital to industrial enterprise by providing a market for the purchase and sale of recognised scrips, but there are no regular stock exchanges in other provinces and even in the regular exchanges of the Presidency cities commercial securities are better canvassed than industrial ones.[2]

A fact that is often lost sight of by enthusiasts is that the capacity of the capital market in India is not unlimited. Deposits and banking have undoubtedly developed in the last fifteen years or so,[3] but one would be too much of an optimist if one imagines that there is

[1] D. L. Dubey : The Indian Public Debt (Bombay, 1930), pp. 295-304.

[2] Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 443-44.

[3] See Appendix X.

still considerable scope for the development of deposits in India. While the slender savings of small men everywhere have yet to be garnered by means of systematic propaganda and by the provision of better banking facilities, it cannot be sufficiently emphasised that the mere opening up of branches at different centres will neither direct nor force development, and they certainly cannot by their own resources replace the capital market. If the country goes on making hoardings or invests the major portion of its funds in *safe* State or municipal loans in preference to industrial securities, neither the banking system nor the individual banks can be blamed for the slow economic development of the country.[1]

This brings us to the question of external capital and the wisdom of employing it in order to accelerate industrial development. It is difficult to estimate the amount of external capital employed in the various undertakings in India, but there is no doubt that a considerable volume of outside capital has been used in the past and is still used.[2] The use of foreign, mainly British, capital has certainly saved much fruitless expenditure of indigenous capital in a number of risky concerns and thereby reduced by a considerable amount the initial costs of development. The question now arises whether the inflow of external capital is attended with any injurious results. No objection can be raised to the principle of employing external capital when internal resources are found to be insufficient, but it is important to see that the external capitalist acquires no special privileges or concessions which would give him exclusive

1 Memorandum on Industrial Banking by Dr. O. Jeidels, Indian Central Banking Enquiry Committee (1931), Vol. IV. pp. 149-51,

2 Report of the External Capital Committee (Simla, 1925), p. 3.

possession or exclusive rights of exploitation of particular portions of the natural resources of India.[1]

The problem at bottom is one of education and intensive propaganda. The utility of the various institutions that exist (like the post office savings banks, co-operative banks etc.) should be brought home to the masses and the encouragement of savings should become an important objective of State policy. Measures should also be taken to encourage the cheque habit which promotes thrift and makes larger savings easier. Further, attempts should be made to inaugurate savings associations or thrift committees on the lines of the National Savings Association in England.[2]

We must not forget that at bottom the unutilised part of the capital goods, the unproductive investment and the unmobilised social savings constitute what might be called the wastage of India's capital resources. Any attempt at solving the difficulties of industrial finance must find a way of preventing this enormous wastage. Hoarding must diminish, by-products must be utilised in any industrial undertaking, the inefficiency of tools and machinery used must be done away with, and every effort should be made to make available the potential capital resources of the country for the services of industry.

1 *Ibid*, pp. 4-10.

2 Indian Central Banking Enquiry Committee (Majority Report), 1931, pp. 440-47.

CHAPTER XIV

CONCLUSION: CERTAIN FUNDAMENTAL FACTS ABOUT THE INDUSTRIAL DEVELOPMENT OF INDIA

So far we have looked at the problem of industrial development in India from the standpoint of finance alone. But difficulties of finance are not the only or even the main impediments that stand in the way of a rapid and harmonious growth of industrial enterprises. The fact that industrial enterprise in India has been singularly restricted and stereotyped until very recent years is due to a variety of reasons. To establish an industry successfully in any country, men, money, materials, markets and motive-power are needed. The inadequacy of India's supply of money is not the only deterrent factor in the way of her industrial progress. With regard to transport and communications she is still at an immense disadvantage, and although wages are low her labour is dear. High-skilled artisans, technical and scientific experts, and industrial leaders are singulaly absent, and unless these pre-requisites are supplied it is inconceivable how a mere augmentation of credit institutions on German, Japanese or British lines can promote the economic devlopment of the country.[1]

The absence of industrial leaders is the most lamentable gap. "The supreme need of the country is for managers and foremen, for pioneers and entrepreneurs."[2]

1 Anstey: *op. cit.*, pp. 227-31.

2 P. P. Pillai: Economic Conditions in India (London, 1925), p. 187.

The Managing Agency system, by concentrating industrial control in a comparatively few hands (often foreign), and by placing such a control on an almost hereditary basis, undoubtedly makes it exceptionally difficult for able, but not well-connected, young men to rise to a position of responsibility. On the other hand, we must not forget that its existence is largely due to the absence of an educated and articulate public opinion and of efficient and honest boards of managing directors.[1]

It is often urged by many that financial assistance given by the State would remove many of the difficulties that confront enterprises in India. Such an assistance is objectionable not merely on grounds of policy but also from the standpoint of practicability. On the other hand, it cannot be denied that a very important gap has been the absence of a real policy on the part of Government. For reasons that need not be discussed here, Government has made little conscious effort to guide schemes of industrial development, nor has it tried, until very recently, to the take an active interest in the matter of industrial regeneration.

In spite of all this, we cannot help remarking that much could be done and can still be done if the average Indian cultivates a less prejudiced outlook and shows better enterprise. The general craving for clerical jobs and for a purely literary education has reached the stage when a halt might usefully be called. We need a blending of sentiment and experience, of a new outlook and a new education.[2] "If the initiative

1 Anstey : *op. cit.*, p. 115.

2 Evidence of Mr. B. N. Basu and Dr. P. C. Roy before the Indian Industrial Commission, 1916-18, vol. II.

of private enterprise in India, stimulated, encouraged and assisted wherever possible by Government action, can make even a proportion of the capital now unproductively used, available for productive enterprise we can look forward with confidence to a very rapid improvement in the general economic conditions of India."[1]

The fact is that financial aid is not the only form of aid that can be given by the State to industry. The instance of countries like Germany and Japan is frequently quoted. We should not forget, however, that what was called the "entrepreneur spirit" in banking in Germany was more the result of private enterprise than of state regulated policy. In Germany it was not banks which created the industries; the funds which were gathered by the banks in increasing volumes were mainly the result of increasing productivity of capital invested in industrial undertakings. And the creative power which in a comparatively short time placed German industry in its present commanding position had its origin in the men who put to practical use the achievements and inventions of science and technique.[2]

A very important mistake that should be avoided by enthusiasts in India is that "a banker cannot and must not be an industrialist." The power of a bank to lend depends on the amount of share capital and of the funds deposited with it, which in turn are conditioned by the income of private individuals and the credit operations resulting therefrom. It is also significant that there has come a

[1] Speech of Sir Basil P. Blackett before the Delhi University, Nov. 27, 1925.

[2] Journal of the Indian Institute of Bankers (Bombay) October, 1932.

profound change in the financing of industry in recent years in many countries of the world: there has been a steady growth in the share of total industrial activity undertaken by the State or other public authorities. The system of financing industry by debt, either through banks or public authorities, or by means of debentures, has increased in almost every country.[1] But the character of the lending operations of banks has not altered much. There has been some strengthening of a few tendencies previously at work: banks are devoting less attention than formerly to discount credits (chiefly self-liquidating) and are to an increasing extent financing industry by direct advances either on current account or in the form of long-term loans.[2] This strengthening has been in part the result of changes in the general economic organisation—e.g., the creation of larger industrial or commercial units with which the banks maintain direct relations and which they finance by means of advances rather than by discount credits. But on the whole banks everywhere have avoided long period commitments in industrial ventures.[3]

Coming back to the case of India, we may say that there is no *real* scarcity of banking facilities here so far as the legitimate demands of organised industry are concerned. Industrial banking and large-scale investments will continue to be distant ideals so long as enterprise in India remains weak, unorganised and inefficient. (Banks and industry can undoubtedly do a lot by mutual co-operation,) but the lead has to come from the economic body of entrepreneurs and not from banks.

1 Economic Essays in honour of Gustav Cassel (London, 1933), pp. 413-14.

2 See Appendix XIII.

3 League of Nations Memorandum on Central Banks, 1913-29 (Geneva, 1931), pp. 47-49.

Deficiency in business experience, want of technical knowledge, absence of the entrepreneur spirit, lack of good leaders—all these often account for difficulty in obtaining finance in the case of many of India's industries. No amount of banking metamorphosis can solve these fundamental defects, and those who look upon the German or the Japanese financial types as panaceas for all our industrial difficulties should not forget that even in Germany it was not the banks that were "the directing force of the spirit of industrial enterprise": there were three special factors in Germany's successful rise—the steady snpport given to industry by legislation and diplomacy, an extraordinary degree of efficiency in the system of co-operation between industry and finance and the particular combination of German mentality plus German method in the arena of business. As has been well put by Reisser, it was "certain elementary economic causes working with irresistible force" that made the most wonderful economic progress of recent times a thing of reality and a marvel for the whole world.

APPENDICES

Appendix I

Joint-stock Companies Registered in India and at work : 1899-1905.

(In tens of rupees where the figures are in rupees.)

		1889-90	1894-95	1899-1900	1904 05
Banking, loan and insurance cos. ...	No.	307	451	450	543
	Capl.	Rs. 3,435,250	Rs. 3,721,645	£ 2,642,015	£ 2,813,707
Railways, tramways and other trading cos.	No.	156	182	279	358
	Capl.	Rs. 2,705,249	Rs. 2,866,228	£ 3,698,921	£ 5,564,728
Tea companies ...	No.	133	154	129	134
	Capl.	Rs. 3.551,734	Rs. 3,672,355	£ 2,169,207	£ 2,281.510
Other planting cos.	No.	11	18	19	20
	Capl.	Rs. 98,499	Rs. 139,924	£ 135,764	£ 122,597
Mining companies ...	No.	21	58	54	73
	Capl.	Rs. 764,486	Rs. 1,801,163	£ 1,105,702	£ 1,894,797
Cotton mills ...	No.	56	57	152	140
	Capl.	Rs. 4,387,372	Rs. 4,857,234	£ 7,780,650	£ 7,839,558
Jute Mills ...	No.	10	13	21	22
	Capl.	Rs. 1,021,120	Rs. 1,463,476	£ 1,919,635	£ 2,628,382
Mills for wool, silk, hemp etc. ...	No.	61	75	25	31
	Capl.	Rs. 3,845,803	Rs. 4,420,484	£ 504,721	£ 849,167
Cotton and jute screws and presses	No.	68	105	113	122
	Capl.	Rs. 1,277,994	Rs. 1,424,315	£ 1,093,144	£ 1,098,227
Other companies ...	No.	54	83	98	107
	Capl.	Rs. 1,689,504	Rs. 2,076,258	£ 1,856,239	£ 1,755,616
TOTAL ...	No.	886	1,204	1,340	1,550
	Capl.	Rs. 23,684,202	Rs. 27,668,773	£ 23,105,998	£ 26,848,289

—Compiled from Statistical Abstracts relating to British India : the figures for 1899-1900 and 1904-05 are given in £ sterling and the rate of exchange over this period is £ 1= Rs. 15.

APPENDIX II

The Registered Debt of India: 1879-1905.

(Rupee loans raised in India only).

Year.	Total.	Proportion of the Rupee Debt held by (a) Europeans	(b) Indians.
1879-80	Rs. 82,87,25,090	Rs. 61,64,71,510	Rs. 21,07,41,710
1884-85	„ 93,18,36,600	„ 66,57,03,350	„ 25,39,97,710
1889-90	„ 102,76,11,750	„ 72,88,18,580	„ 29,87,18,630
1894-95	„ 104,37,37,400	„ 74,23,32,880	„ 29,73,38,350
1899-1900	„ 112,47,47,010	„ 65,26,98,494	„ 47,25,19,164
1904-05	„ 122,29,78,235	„ 71,26,97,541	„ 54,83,05,489

Note A. The figures giving the proportion of the Rupee Debt held by Europeans and Indians relate to the years ending with the 31st December, hence the discrepancy from the total figures.

Note B. The decrease in the holdings by Europeans and the corresponding increase in the holdings by Indians from 1899-1900 onwards are due to the rectification of a loose and erroneous classification in the Public Debt Office, where until 1897-98, notes presented for payment of interest by the banks were treated as held by Europeans, though the owners were often Indians.

—Compiled from the Statistical Abstract of British India, Part IV (a), Calcutta, 1908.

APPENDIX III

Joint-stock Companies Registered in India and at work: 1921-1931.

(A) Companies registered in British India.

		1921-22	1924-35	1927-28	1930-31
No.	...	4,781	4,822	5,388	6,675
Paid-up capital (In thousands of rupees)	...	Rs. 2,22,84,00	Rs. 2,66,50,00	Rs. 2,66,71,00	Rs. 2,71,12,00

(B) Companies registered in the Indian States.

		1921-22	1924-25	1927-28	1930-31
No.	...	408	382	442	653
Paid-up capital (In thousands of rupees)	...	Rs. 7,71,00	Rs. 9,03,00	Rs. 9,72,00	Rs. 11,40,00

—Compiled from the Statistical Abstract for British India, Delhi, 1933.

APPENDIX IV

Industrial Development in India : 1921-1931.

(A) Number and paid-up capital of Cotton mills in India.

British India :

	1921-22	1925 26	1930-31
No. ...	237	255	261
Paid-up capital (In thousands of rupees) ...	Rs. 39,14,00	Rs. 42,22,00	Rs. 33,53,00

Indian States and Foreign Territory :

No. ...	34	48	49
Paid-up capital ... (In thousands of rupees and sterling)	Rs. 1,82,00 £ 2,00	Rs. 5,28,00 £ 4,00	Rs. 4,98,00 £ 1,00

(B) Production of Cotton mills (British India, the States and Foreign Territory).

	1921-22	1925-26	1930-31
Yarn (In million lbs.) ...	694	686	867
Woven goods (In million lbs.) ...	404	465	590

(C) Jute mills in India.

	1921-22	1925-26	1930-31
No. of looms employed ...	43,025	50,503	61,834
No. of spindles employed ...	908,359	1,063,700	1,224,982
Average no. of persons employed ...	288,450	331,326	307,676

(D) *Factories subject to the Indian Factories Act.*
(British India only).

	1921	1924	1927	1930
No. of factories subject to the Act ...	3,965	6,406	7,515	8,148
Average no. of hands employed daily ...	1,266,395	1,455,592	1,533,382	1,528,302

(E) *Production of Coal in British India and the Indian States.*

	1921	1924	1927	1930
Quantity (In million tons) ...	19	21	22	24
Value (In thousand rupees) ...	Rs. 13,01,01	Rs. 14,96,53	Rs. 9,48,70	Rs. 9,26,25

Note.—The fall in the value is due to depression.

(F) *Production of Iron-ore in British India and the Indian States.*

	1921	1924	1927	1930
Quantity (In thousand tons) ...	942	1,445	1,847	1,850
Value (In thousand rupees) ...	Rs. 13,04	Rs. 25,33	Rs. 51,02	Rs. 48,73

(G) *Tea Companies registered in India.*

	1921-22	1925-26	1930-31
British India :			
No. ...	401	401	481
Paid-up capital (In thousand rupees) ...	Rs. 8,25,00	Rs. 9,76,00	Rs. 12,74,00
Indian States :			
No. ...	3	5	11
Paid-up capital (In thousand rupees) ...	Rs. 6,00	Rs. 13,00	Rs. 43,00

—Compiled from the Statistical Abstract for British India, Delhi, 1933.

APPENDIX V

Classification of Joint-Stock Companies at work in India in 1930-31.

(To be compared with the Tables in Appendix I)

N.B.—Some figures in the last column have been left out because the paid-up capital in those cases is less than half a million £.

A. Companies registered and at work in British India.
B. Companies registered and at work in the Indian States.
C. Companies registered outside India, but at work in India.

		A		B		C	
		No.	Paid-up capital (In lakhs of Rs.)	No.	Paid up capital (In lakhs of Rs.)	No.	Paid-up capital (In million £)
1.	Banking and Loan ...	1,647	2,232	321	363	29	96
2.	Insurance ...	212	220	25	4	141	69
3.	Navigation ...	31	264	...	...	19	41
4.	Railways and tramways	45	1,501	1	7	19	28
5.	Other transport ...	229	371	15	3	10	1
6.	Trading and manufacturing companies	2,518	9,305	166	144	357	292
7.	Tea	481	1,274	11	43	182	27
8.	Other planting companies	90	199	26	40	45	5
9.	Coal mining ...	216	911	1	63	4	...
10.	Gold mining ...	3	4	...	...	6	2
11.	Other mining companies	104	2,890	9	13	34	111
12.	Cotton mills ...	272	3,247	30	428	8	...
13.	Jute mills ...	68	1,758	...	...	6	3
14.	Mills for wool, silk, hemp etc. ...	19	245	1	4	...	...
15.	Cotton ginning, pressing etc.	98	228	5	12	2	...
16.	Jute presses etc. ...	28	175	1	5	...	...
17.	Flour mills ...	24	129	1	...	...	...
18.	Estate, land and building	135	977	2	1	6	...
19.	Sugar	32	200	2	4	1	...
20.	Other companies ...	423	982	26	7	28	66

—Compiled from the Statistical Abstract for British India, Delhi, 1933.

APPENDIX VI

Joint-stock Companies registered elsewhere than in India, but working in British India and Indian States.

(To be compared with the Tables in Appendix III).

(A) Companies working in British India.

	1921-22	1924-25	1927-28	1930-31
No. ...	676	756	824	853
Paid-up capital (In million sterling) ...	£ 508	£ 614	£ 619	£ 729

(B) Companies working in the Indian States.

	1921-22	1924-25	1927-28	1930-31
No. ...	34	33	37	44
Paid-up capital (in million sterling) ...	£ 6	£ 4	£ 13	£ 14

—Compiled from the Statistical Abstract relating to British India, Delhi, 1933.

APPENDIX VII

Table showing the independence of the various rates in the Indian Money Market.

	Imperial Bank Rate.	Call money rate. Calcutta.	Call money rate. Bombay.	Imperial Bank Hundi Rate.	Bazar bill rate. Calcutta.	Bazar bill rate. Bombay.
	%	%	%	%	%	%
1929.						
April ...	8	5	$6\frac{1}{2}$	8	11-12	11
May ...	7	$2\frac{1}{2}$	$3\frac{1}{2}$	7	10-11	$8\frac{3}{4}$
June ...	6	$1\frac{1}{2}$	$3\frac{1}{4}$	6	10-11	$6\frac{3}{4}$
July ...	5	$1\frac{1}{2}$	$1\frac{1}{2}$	5	10	5.5/16
August ...	5	Nil	$1\frac{1}{2}$	5	10	5.5/16
September ...	5	$1\frac{1}{2}$	$1\frac{1}{2}$	5	11	6
October ...	5	$2\frac{1}{2}$	$3\text{-}3\frac{1}{2}$	5	11	7.3/16
November ...	7	2	$2\frac{1}{2}$	7	11	$8\frac{3}{4}$
December ...	7	$1\frac{1}{2}$	$4\frac{1}{2}$	7	11	9.1/16
1930.						
January ...	7	3	5	7	11	9.1/16
February ...	7	$4\frac{1}{2}\text{-}5\frac{1}{4}$	$6\frac{1}{2}$	7	11	$9\frac{3}{4}$
March ...	7	5	$4\frac{3}{4}$	7	11	9.1/16

N.B.—The bazar rates above are those at which the bills of small traders are discounted by *shroffs*. The rates for bills of large traders and *shroffs* are not given as they follow the Imperial Bank *hundi* rate closely.

—The Indian Central Banking Enquiry Committee (Majority Report), Cal. 1931.

Appendix VIII

Capital, Reserve and Deposits of the Imperial Bank of India (on 31st December each year).

(In Rs. 1,000).

	Paid-up Capital.	Reserve and the rest.	Total.	Deposits.		
				Public.	Private.	Total.
1870	3,36,25	25,57	3,61,82	5,43,05	6,39,61	11,82,66
1890	3,50,00	97,54	4,47,54	3,59,25	14,76,35	18,35,60
1910	3,60,00	3,31,03	6,91,03	4,23,63	32,34,38	36,58,01
1920	3,75,00	3,77,79	7,52,79	9,02,63	78,01,90	87,04,53
1921	5,62,24	4,14,54	9,76,78	6,80,01	65,77,99	72,58,00
1924	5,62,50	4,80,08	10,42,58	7,50,26	76,71,22	84,21,48
1927	5,62,50	5,24,07	10,86,57	7,20,23	72,07,22	79,27,45
1931	5,62,50	5,14,05	10,76,55	8,32,11	63,85,64	72,17,75

Note.—Figures for years prior to 1921 represent the totals of the three Presidency Banks of Bengal, Bombay and Madras which were amalgamated and formed into the Imperial Bank of India with effect from the 27th January, 1921.

—Compiled from Statistical Tables relating to Banks in India, Delhi, 1933.

APPENDIX IX

Capital, Reserve and Deposits of the Principal Indian Joint-stock Banks. (On the 31st December each year). (In Rs. 1,000).

Class A.—Banks with Capital and Reserve of Rs. 5 lakhs and over.

	No. of reporting banks.	Paid-up capital.	Reserve and the rest.	Total.	Deposits.
1870	2	9,83	1,82	11,65	13,95
1890	5	33,50	17,58	51,09	2,70,78
1910	16	2,75,66	1,00,55	3,76,21	25,65,85
1920	25	8,37,02	2,55,46	10,92,48	71,14,64
1924	29	6,90,55	3,80,39	10,70,94	52,50,52
1927	29	6,88,70	4,19,35	11,08,05	60,84,11
1931	33	7,77,32	4,26,04	12,03,36	62,23,48
Class B.—Banks with Capital and Reserve between Rs. 1 lakh and Rs. 5 lakhs.					
1915	25	45,38	9,73	55,11	91,37
1920	33	61,42	19,95	81,37	2,33,46
1924	41	73,65	34,34	1,07,99	2,69,06
1927	48	84,95	37,25	1,22,20	3,45,58
1931	51	83,22	40,55	1,23,77	3,83,81

—Compiled from Statistical Tables relating to Banks in India, Delhi, 1933.

Appendix X

Capital and Reserve and Deposits of the Imperial Bank of India, Exchange Banks, and Indian Joint-Stock Banks, 1923-31.

(In thousand rupees).

Year.	Imperial Bank of India.		Exchange Banks.		Joint-Stock Banks.		Total of all Banks.	
	Capital and Reserve.	Deposits.	*Capital and Reserve.	Deposits (in India).	Capital and Reserve.	Deposits.	Capital and Reserve.	Deposits.
1923	10,17,71	82,76,45	1,86,80,40	68,44,28	10,84,78	47,69,32	2,07,82,89	1,98,90,05
1925	10,55,23	83,29,77	1,84,41,47	70,54,57	11,78,13	57,90,76	2,06,74,83	2,11,75,10
1927	10.86,57	79,27,45	2,41,22,60	68.86,23	12,30,35	64,29,69	2,64,39,42	2,12,43,37
1929	11,10,26	79,24 28	3,03 50,00	66,65,91	12,68,53	66,29,54	3,27,28,79	2,12,19,73
1931	10,76,55	72,17,55	2,47,95,20	67,47,26	13,27,13	66,07,29	2,71,98,88	2,05,72,30

**Conversion made at the rate of 1s. 6d. = Re. 1.*

—Compiled from Statistical Tables relating to Banks in India, Delhi, 1933.

A31.

APPENDIX XI

Number of Co-operative Societies for all India : 1906-1932.

	Central (Provincial and Central Banks and Banking Unions) Societies.	Agricultural Societies.	Non-agricultural Societies.
Average for 4 years from 1906-07 to 1909-10 ...	17	1,713	196
Average for 5 years from 1910-11 to 1914-15 ...	231	10,891	664
Average for 5 years from 1915-16 to 1919-20 ...	312	25,873	1,662
Average for 5 years from 1920-21 to 1924-25 ...	1,808	51,716	4,183
Average for 5 years from 1925-26 to 1929-30 ...	1,981	83,093	8,862
1930-31 ...	1.863	93,773	10,530
1931-32 ...	1,696	93,598	10,756

—Compiled from Statistical Statements relating to the Co-operative Movement in India, Delhi, 1933.

APPENDIX XII

Working Capital of Co-operative Societies for all India: 1906-32. (In thousand rupees).

	Share capital Paid-up.	Loans and Deposits held at the end of the year from members.	Loans and Deposits held at the end of the year from Societies and Provincial Central Banks.	Loans and deposits held at the end of the year from Government.	Loans and deposit held at the end of the year from non-member and other sources.	Reserve and other funds.	TOTAL.
Average for 4 years from 1906-07 to 1909-10 ...	13,19	14,12	13,59	5,86	19,69	1,67	68,12
Average for 5 years from 1910-11 to 1914-15 ...	88,87	88,28	1,93,42	10,87	1,41,98	25,00	5,48,42
Average for 5 years from 1915-16 to 1919-20 ...	2,51,97	96,35	5,51,00	25,58	4,70,25	1,23,32	15,18,47
Average for 5 years from 1920-21 to 1924-25 ...	5,25,66	2,54,45	13,79,86	67,69	10,96,22	3,12,38	36,36,26
Average for 5 years from 1925-26 to 1929-30 ...	9,94,17	5,03,42	27,55,31	1,63,34	23,69,68	7,13,21	74,89,13
1939-31 ...	12,40,83	6,77,93	32,49,83	1,74,81	28,15,70	10,32,12	91,91,22
1931-32 ...	12,65,60	6,83,12	31,49,63	1,68,72	28,58,57	11,43,51	92,69,15

—Compiled from Statistical Statements relating to the Co-operative Movement in India, Delhi, 1933.

APPENDIX XIII

Movement of Deposits, Credits and Investments in some of the principal countries of the world.

TABLE—COMPOSITION OF CREDITS:

(a) Discounts.
(b) Loans and Advances.
(c) Total Discounts, Loans and Advances.
(d) Investments and Participations.

As % ages of the total of these items.

		1913	1920	1923	1926	1929
		%	%	%	%	%
Austria	(a)	22 1	6.2	3.8	11.8	12.4
	(b)	66.9	88.7	83.7	77·5	77.0
	(c)	89.0	94.9	87.6	89.3	89.4
	(d)	11.0	5.1	12.5	10.7	10.6
Belgium	(a)	26.8	15.3	15.2	20.3	21.4
	(b)	48.5	51.8	54.7	56.8	59.8
	(c)	75.3	67.1	69.9	77.1	81.2
	(d)	24.7	32.9	30.1	22.9	18.8
France (Deposit Banks)	(a)	58.2	68.7	71.4	72.7	64.5
	(b)	39.4	30.1	27.4	26.4	34.8
	(c)	97.6	98.8	98.8	99.1	99.3
	(d)	2.4	1.2	1.2	0.9	0.7
France (Investment Banks)	(a)	26.5	43.7	46.0	36.1	30.9
	(b)	50.8	37.1	38.8	49.1	52.6
	(c)	77.3	89.8	84.8	85.2	83.5
	(d)	22.7	19.2	15.2	14.8	16.5
Germany	(a)	27.2	59.1	12.9	25.5	23.3
	(b)	57.1	37.6	72.2	67.4	70.9
	(c)	84.3	96.7	85.1	92.9	94.2
	(d)	15.7	3.3	14.9	7.1	5.8

England and Wales	(a)	14.4	20.2	18.6	15.6	14.6
	(b)	66.8	58.6	56.2	65.7	68.4
	(c)	81.2	78.8	74.8	81.3	83.0
	(d)	18.8	21.2	25.2	18.7	17.0
Scotland	(a)	15.6	16.7	11.1	8.4	9.1
	(b)	51.6	43.1	39.3	51.0	55.7
	(c)	67.2	59.8	50.4	59.4	64.9
	(d)	32.8	40.2	49.6	40.6	35.2
Ireland	(a)	7.0	4.7	4.6	4.0	2.7
	(b)	59.9	52.8	48.3	50.8	50.4
	(c)	66.9	57.5	52.9	54.8	53.1
	(d)	33.1	42.5	47.1	45.2	46.9
U. S. A.	(a)	...	...	...	...	...
(All Commercial	(b)	...	...	...	...	...
Banks)	(c)	77.6	76.6	71.8	71.6	72.4
	(d)	22.4	23.4	28.2	28.4	27.6

—Compiled from the League of Nations Memorandum on Commercial Banks, 1913-1928, Geneva, 1931.

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INDEX

INDEX